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CAPITAL FORBEARANCE FOR AGRICULTURAL BANKS

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ORIGINAL

HEARING

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON

GOVERNMENT OPERATIONS

HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SECOND SESSION

JUNE 17, 1986

Printed for the use of the Committee on Government Operations

U.S. GOVERNMENT PRINTING OFFICE

62-432 O WASHINGTON : 1986

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

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CAPITAL FORBEARANCE FOR AGRICULTURAL BANKS

TUESDAY, JUNE 17, 1986

HOUSE OF REPRESENTATIVES,
COMMERCE, CONSUMER, AND
MONETARY AFFAIRS SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:45 a.m., in room 2203, Rayburn House Office Building, Hon. Doug Barnard, Jr. (chairman of the subcommittee) presiding.

Present: Representatives Doug Barnard, Jr., John M. Spratt, Jr., and Larry E. Craig.

Also present: Donald P. Tucker, chief economist; Richard W. Peterson, counsel; Faye Ballard, clerk; and Scott Fisher, minority professional staff, Committee on Government Operations.

OPENING STATEMENT OF CHAIRMAN BARNARD

Mr. BARNARD. The subcommittee will come to order.

Today's hearing by the Commerce, Consumer, and Monetary Affairs Subcommittee examines the initial experience of the Federal bank regulatory agencies with their recently announced policy of capital forbearance toward agricultural and energy banks.

The requirements of the Federal banking agencies regarding the amount of capital a bank must have relative to its total assets are among the most basic and fundamental regulatory standards the agencies have for insuring sound banking practice.

This committee on several occasions has expressed to the agencies its concern that these capital requirements be both carefully designed and vigorously enforced. We have not changed our basic outlook on that. Active and tough bank supervision at the Federal level continues to be one of our principal oversight objectives.

Vigorous enforcement and tough supervision can and should always include some element of flexibility, however, as long as the safety and stability of the banking and deposit insurance systems are not compromised. The issue before us today is exactly this: How to allow some flexibility in the Federal supervision of banks in regions of the country that have been especially hard hit by the problems of the agriculture and the energy industries.

In order to assure some such flexibility, the FDIC and the Comptroller of the Currency have both adopted policy statements as of the end of March regarding capital forbearance for agricultural and energy banks. This means a policy of going easy or temporarily

suspending the normal enforcement of the capital standards for banks serving these hard-hit industries as long as the banks continue to be well managed and have good prospects for being able to come back into compliance if allowed a little more time.

We commend the agencies for attempting to fashion a policy that will buy time for qualifying institutions whose internal difficulties arise primarily from adverse economic conditions beyond their control.

Nevertheless, we have some concern about how effectively this policy statement translates into true forbearance. This hearing has been called, therefore, to gain some insight into how this policy is actually being administered out in the field and what effects it is expected to have to assist not only the banks themselves but also the banks' customers in the communities where they operate.

We are very pleased to welcome today Mr. Meadows and Mr. Downey from the FDIC and the Comptroller of the Currency who are probably the senior officials most closely involved with managing the Capital Forbearance Program for their agencies.

We are also very pleased today to have with us Mr. Walter Howard of the Treasure Valley Bank in Fruitland, ID, and Mr. Thomas Brooks, who was the FDIC's general counsel from 1981 to 1984 and who now has a private practice that includes working with banks that are considering the Capital Forbearance Program.

This hearing also represents a real joint effort initiated by the distinguished ranking minority member from Idaho, Mr. Craig, and before we begin I would like to invite Mr. Craig to make an opening statement.

Mr. CRAIG. Thank you very much, Mr. Chairman.

Many times I have started my opening remarks by thanking you for the hearings you hold and the preparation work that is done in advance of those hearings, and certainly it is no different today. A very sincere thanks to you, Mr. Chairman, and to your staff for calling this hearing today, a particular hearing in which we will review the initial experience of the Federal bank regulatory agencies with their recent announced policy of capital forbearance toward agriculture and energy banks.

Mr. Chairman, we are all aware of the growing debt crisis that has our Nation's Farm Belt in a stranglehold and threatens the very existence of hundreds of American banks. Rural banks, in general, and farm banks, in particular, once considered among the healthiest group in the banking industry, have been failing at record rates in the last couple of years because of the economic crisis in agriculture.

Since the farm debt problem began in the early 1980's, the value of farmland, farm machinery, and other capital assets has plummeted by nearly a third nationwide and by 50 percent in some locations. In Idaho, the farmland alone has dropped in value by nearly 40 percent.

As farm values nose-dived, banks' lines of credit to farmers have been pushed to the limit where possible and cut off, causing massive foreclosures, to ensure the bank's financial stability and continued operation.

To a farmer, a line of bank credit is as important as the soil he tills. Without it, his entire farm operation dries up and blows away

like a field of grain succumbing to a rainless summer. If you can't get the resources to plant and nurture the crop, then you can't harvest the crop. If you can't harvest, you can't sell, and if you can't sell the crop, you can't always pay back your banker.

When the banker can't raise the capital as fast as he writes off the losses, guess who comes knocking at his door? Well, it's your friendly Federal bank regulator.

Farm credit comes from several different sources—commercial banks, the Farm Credit System, and the Farmers Home Administration. While Congress has addressed the FCS and the Farmers Home Administration's problems, our commercial banks with primarily agricultural portfolios have had to fight on their own in large part to survive.

Most agricultural banks are still sound, but the number of individual banks with problem loans continues to increase daily. FDIC and OCC officials have stated that they do not believe agricultural bank problems will affect the safety and the soundness of the Nation's banking system.

While banks with 25 percent or more of their loan portfolio in farm loans represents nearly 28 percent of the banking population, total assets of these banks are equal to only about 4 percent of all bank assets. Mr. Chairman, I don't know if that's good or bad.

It is good that the large number of troubled or failed farm banks do not threaten the safety and the soundness of the Nation's banking system and the Federal deposit insurance funds. But because farm bank assets make up such a small percentage of the total bank assets, and the fact that many of the farm banks are small in size, I wonder if Federal regulators view them as more of a stepchild of the overall banking family, especially when it comes to the point of needing a little understanding.

Nevertheless, the precarious conditions of the agriculture and oil economy and the problems being experienced by farm and oil borrowers and their lenders did receive special attention by the FDIC and OCC.

In late March 1986, both Federal regulatory agencies issued capital forbearance policies for agriculture and energy banks. I would like to commend the FDIC and the Comptroller of the Currency for their initiative in establishing a capital forbearance policy as an important tool in responding effectively to well-managed commercial banks experiencing temporary capital problems.

I appreciate the Federal agencies for attempting to fashion a policy designed to buy time for qualifying institutions whose difficulties arise primarily from adverse economic conditions beyond their control.

However, I am very concerned, based on information I have received from banks in the Pacific Northwest, that this policy may be resulting in a meaningful degree of true forbearance for the institutions it was designed to help.

Finally, Mr. Chairman, let me conclude by assuring you and our guests today that in no way am I advocating special treatment for any bank which has incurred an economic problem due to the bank's mismanagement.

Congress has instructed the bank regulatory agencies to act in a swift and firm manner in the area of significant mismanagement,

and I strongly support that directive. I join with you today in welcoming the witnesses and look forward to their testimony.

Thank you very much, Mr. Chairman.

Mr. BARNARD. Thank you, Mr. Craig.

Our first panel this morning will consist of Mr. Walter Howard and Mr. Thomas Brooks. If you two gentlemen would please take the witness stand at this time.

While Mr. Brooks certainly needs no introduction to this committee, Mr. Howard I think, certainly deserves some, and I'm going to ask our distinguished ranking minority member if he would like to introduce the gentleman from Idaho.

Mr. CRAIG. Thank you very much, Mr. Chairman.

Walter Howard—or Wally Howard—is formerly the president and CEO of Treasure Valley Bank in Idaho, a State bank, a bank that is some 12 to 13 years old, has had a strong growth pattern over the years, and which is, like many Idaho banks now, because of a strong ag portfolio, beginning to experience difficulties as a result of the ag economy.

Mr. Howard is known and respected in Idaho. When I went out to secure witnesses to testify before this committee today, in talking with the finance director of the State of Idaho—Mr. Tom McEldowney, whom I've worked with over the years—Mr. Howard's name came first to mind from Mr. McEldowney as somebody who could represent well the situation of the agricultural banking difficulties in Idaho and the problems that particular banks are experiencing. I welcome, as our chairman does, Mr. Howard to the committee today.

Thank you for coming, Wally.

Mr. HOWARD. Thank you.

Mr. BARNARD. Welcome, Mr. Howard and Mr. Brooks.

Mr. Howard, your entire testimony will be included in the record. I see you just have two pages, so you might want to just go ahead and read it as it is. If you care to summarize, that will be fine, but, without objection, your entire testimony will be included in the record.

STATEMENT OF WALTER A. HOWARD, FORMER PRESIDENT AND CEO, TREASURE VALLEY BANK, FRUITLAND, ID

Mr. HOWARD. Good morning, Mr. Chairman and Congressman Craig and other members of the committee.

I am Wally Howard, former president and CEO of Treasure Valley Bank, which is a State-chartered bank, and I have retired after 30 years of banking in Idaho but remain on the board of directors of Treasure Valley Bank.

My report will be a report of the process we experienced in applying for the Capital Forbearance Program as provided for ag bankers in the FDIC bulletin BL-12-86 dated March 27, 1986.

Our bank applied for the program on April 21, 1986. We were notified by telephone a few days later by the assistant regional director that our application lacked the corporate resolution by the board of directors. We informed him that we would forward the resolution to complete the application.

The assistant director discouraged our application and stated that they would not recommend the application to Washington, DC. We asked what the problem was, and he stated that management—the CEO—was inadequate and had not done an adequate job of supervising branches.

As a result of this phone conversation and because of the importance of the Capital Forbearance Program to our bank, I have resigned. We have gone to the outside and hired a president and CEO who is qualified to run the bank and is acceptable to the FDIC.

The San Francisco office of the FDIC has subsequently informed us that they will continue to recommend negative action when they submit the Treasure Valley Bank application to Washington, DC. The FDIC in San Francisco has suggested four times by phone that we withdraw our application.

Subsequent to this information, the San Francisco office of the FDIC has informed our new CEO that they are not required to submit the application to Washington, DC, but have the regional authority to approve or deny the application to participate in the Capital Forbearance Program.

The attitude of our bank's management and board of directors is to cooperate 100 percent with the FDIC. We are doing everything possible to lower classified loans and increase capital. We need some time to accomplish this goal with a difficult economy in the agriculture climate where we operate. The Capital Forbearance Program would help.

We find that the field examiners are tough and are scared to death of the economy. They are also scared of the congressional critics.

The FDIC and other regulators have developed a good economical policy in the capital forbearance plan. However, economic results required the plan and implementation. Treasure Valley Bank qualifies, needs, and deserves the Capital Forbearance Program.

Our bank in 1986 is in the process of removing or trying to remove all substandard loans. This process was suggested by our FDIC examiners, and they do have our attention. I bring this to you to say that this will be devastating to our local economy, and if this happens across the United States in all of the small ag towns it will have a devastating impact on the U.S. economy.

What the ag borrower needs is banks that will forbear on farm loans through appropriate debt restructuring, recognizing that such restructuring may be in the interests of both the bank and the ag borrower when there is a reasonable prospect that the borrower will eventually be able to repay the loan. We have discovered from our last examination that any restructure, regardless of collateral or cash flow, brings an automatic loan classification.

Thank you for listening to the frustrations of a small town agriculture bank by a retired and tired ag banker. If you have any questions, I'd be happy to answer them.

[The prepared statement of Mr. Howard follows:]

STATEMENT OF

WALTER A. HOWARD

FORMER PRESIDENT AND CHIEF EXECUTIVE OFFICER
TREASURE VALLEY BANK
FRUITLAND, IDAHO

BEFORE THE

COMMERCE, CONSUMER AND MONETARY
AFFAIRS SUBCOMMITTEE
of the
COMMITTEE ON GOVERNMENT OPERATIONS
UNITED STATES HOUSE OF REPRESENTATIVES

JUNE 17, 1986
10:00 a.m.

Good morning, Mr. Chairman, Congressman Craig and members of the Committee. I am Wally Howard, former President and Chief Executive Officer of Treasure Valley Bank, a state bank. I have retired after thirty years of banking in Idaho but have remained on the Board of Directors of Treasure Valley Bank.

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Thank you for listening to some of the frustrations of a small town agricultural bank by a retired and tired Ag banker.

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Mr. BARNARD. Thank you very much.
Mr. Brooks.

STATEMENT OF THOMAS A. BROOKS, PARTNER, DICKSTEIN, SHAPIRO & MORIN, FORMER GENERAL COUNSEL, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. BROOKS. Good morning, sir.

Thanks very much for inviting me to appear today. I also, because of the hour of the morning, shall be brief and just summarize the statement that I have, as you have already stated that it will be printed in full in the record.

Mr. BARNARD. Without objection, sir, your entire statement will be included in the record.

Mr. BROOKS. Thank you.

There are a couple of comments I should make, Mr. Chairman. One, it would be interesting to speculate what the regulators might have done or how soon they would have done anything in this area were it not for Congress pushing them and threatening legislation in this area, and as soon as that was a real possibility, the policies evolved from the regulators regarding capital forbearance.

I mention that because it's my feeling that over the last few years this subcommittee, in particular, has been very critical—rightfully so—of the banking regulators and the actions that they have taken in certain cases, like Penn Square, United American Bank, Empire Savings, and that, quite frankly, has made, the regulators very, very sensitive as to finding problems in financial institutions as early as possible and moving very quickly to resolve those problems.

I also might add that the energy and the ag problems are not anything new. Through the examination process I think the regulators have seen them coming, have seen them building over the last 2 to 3 years.

All of a sudden, the examiners and the field staff are presented with a policy which requests them to do an almost 180-degree turn, and that is, we see problems in the ag banks, we see problems in energy banks, but we're going to forbear, we're not going to require those loans to be written down necessarily against a bank's capital if they can comply with the other provisions of this program. There is a lot of control that the regulators have in this program, the management factor being one element, as well as no insider abuses, and things of that nature which I think are very properly structured.

But you now have these agencies looking at these institutions differently. I'm sure that there was a lot of internal debate that went on before these policies evolved, regarding such questions as why should we forbear on some of these banks when perhaps the banker across the street has run—for whatever reason—a good bank, doesn't necessarily have the problem loans that his competitor has, but he has to maintain minimum capital, and has to be treated differently?

Again, I have not been privy to those discussions, but I think that questions like that had to be asked in the evolutionary process of this policy.

On the other hand, it's not without some precedence that the agencies have come forth with preferential treatment for certain kinds of institutions. The FDIC, in particular, as related to mutual savings banks in the past, treated them differently as far as capital requirements were concerned, did not mandate that they be at a 6-percent or 5.5-percent level right away, and gave them time to work out their problems.

Additionally, the Congress enacted a couple of years ago the Net Worth Certificate Program, and that basically was a program designed to put regulatory capital into institutions that had capital ratios of 1.5, 2, or 3 percent—something like that—to basically, quite frankly, artificially inflate their balance sheet to put off a problem that really was in existence because of the negative spreads on the portfolio yield and the cost of funds of some of these institutions.

Congress saw fit in that situation to come up with a program, and the agencies have implemented that program in good faith and, I think, very, very well.

I cannot speak with any experience as to how the agencies are implementing this particular capital forbearance program. I do represent a financial institution that is in the process of making an application with the FDIC, but we have not had contact with them at this time.

Nevertheless, it's a program that I think can be equated to the Net Worth Certificate Program in that it is designed to assist financial institutions over what is perceived to be an interim timetable.

As soon as we can get over this agricultural and energy hump in our economy, then presumably the institutions that participate in this program will be fine, because allegedly the only problems in their portfolio relate to these two particular sectors.

That's the same principle that really was pushing the Net Worth Certificate Program in that as soon as interest rates fell the cost of funds would be less than the portfolio yield, and the institutions would start making money again. Then they could start accumulating earnings and paying back on these net worth certificates that the agencies had basically given them.

So we're at the early stages of this program. There obviously is some experience there. It would be interesting to hear what that experience is.

Thank you.

[The prepared statement of Mr. Brooks follows:]

STATEMENT OF

THOMAS A. BROOKS

PARTNER

DICKSTEIN, SHAPIRO & MORIN

WASHINGTON, D.C.

Before the

COMMERCE, CONSUMER and MONETARY
AFFAIRS SUBCOMMITTEE

of the

COMMITTEE ON GOVERNMENT OPERATIONS

HOUSE OF REPRESENTATIVES

Hearing on

CAPITAL FORBEARANCE

June 17, 1986

Thank you very much for inviting me to testify today regarding the capital forbearance policies of the Federal Deposit Insurance Corporation and the Comptroller of the Currency. The policies of the two agencies are virtually identical, and they were adopted because of the impact on commercial banks by the depressed energy and agricultural sectors of our economy. They are designed to allow a bank to operate with less than the minimum amount of capital required by regulation, without the bank being the subject of an enforcement action. Of course, certain conditions must be met before the policy becomes applicable.

In addition to the farm and energy problems, the policies were enacted because if the regulators did nothing, Congress was prepared to pass legislation to deal with this issue. It is interesting to speculate whether the regulators would have done anything at all if no Congressional pressure had been applied. Clearly, the problems did not arise overnight. For more than the past two years, through their examination process, the regulators have been aware that problems in both industries have been the cause for the weakening of many balance sheets of banks in the Midwest and the Southwest. While the steep drop in oil prices this Spring brought this matter to a head, the regulators knew of the problem well in advance, but offered very little assistance to these institutions.

And why should the regulators have offered to assist these problem banks? Historically, all banks have been treated the same. If a loan was bad, regardless of the reason, the examiner required the bank to write it off against capital. Simply put, this is just good, old-fashioned conservative supervisory action. Why should a bad farm or energy loan be treated differently from a bad business loan? The regulators are not in the business of providing financial assistance to problem banks or turning their heads when they see a problem. The standard approach to a bank is "You've got yourself in this problem, you get yourself out of it." If the banks did not resolve their own problems, enforcement actions were taken.

While this might seem to be a tough and insensitive position for the regulators to take, we must remember that in the last few years the regulators have been the subject of much criticism by the public in general, and especially by this Subcommittee. The criticism has been that in light of Penn Square in the case of the OCC, United American Bank in the case of the FDIC, and Empire in the case of the FHLBB, the regulators were slow to discover problems and once discovered, inadequate action was taken to correct the problem. I am not at all suggesting that this criticism was not justified. Its effect, however, has been as intended. It has made the regulators more concerned that they do not miss anything in an examination; and if they find something irregular, that quick action be taken to

correct the problem. In other words, the conservative examiner became more conservative.

And now, all of a sudden after a few years of increased pressure to find problems early and correct them as quickly as possible, examiners are being told if you find a farm or energy bank that has problems, don't be tough on them; don't bring any enforcement action against them; don't worry that they don't meet minimum capital standards. Of course there are substantive requirements of the program which continue to give the regulators strong control over these problem banks. But, the philosophical approach, the mental framework within which the examiners have been guided in the past, is now different.

I was not privy to the internal debate as the capital forbearance policy evolved, but I am sure someone must have asked "Why should we help these banks? Why should they be treated special?" Why does Bank A not have to have minimum capital, when Bank B, his competitor across the street, has to comply? Bank B is in the same town, but either made "good" farm or energy loans or otherwise managed itself so well that it is not negatively affected by the local economy. Is the difference in the two banks one of "management", and if Bank A is mismanaged, will it be ineligible for participation in the capital forbearance program? The fact that a bank's problems cannot be the result of

mismanagement gives the regulators great discretion as to who can participate in the program and how it is to be implemented.

Will this discretion be abused? I think not. Notwithstanding the regulators traditional approach of being tough with banks with problem loans, they are pragmatic enough to realize that there are not many good alternatives. As I mentioned in the attached article in the June 12, 1986 issue of the American Banker, it is most difficult for a bank to increase its capital in an environment of increasing loan losses and decreased earnings. Additionally, in the past, special situations called for special action by the regulators. Past capital policies of the FDIC have treated mutual savings banks with very low capital differently from other insured institutions. Additionally, the net worth certificate program enacted by Congress sought to provide a remedy to a problem which was viewed as temporary in nature.

The capital forbearance program can be viewed similarly. It is a special program for a special problem. It can only be implemented under certain specific situations. It is not for all banks who are negatively impacted by the depressed farm and energy sectors of our economy. There must be "light at the end of the tunnel" as far as the bank's ability to survive is concerned. The federal regulator will have to make this decision. The regulator will have to balance its historically

conservative approach to supervision, with the pragmatic view of whether or not the bank can survive in the interim to become financially strong once again.

Thank you for your time and I shall be happy to answer any questions you might have.

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Counselor's Corner

Forbearance Policies Offer Enforcement Relief

By THOMAS A. BROOKS

IN THE LAST FEW WEEKS, much has been written about the new capital forbearance policies of the federal bank regulatory agencies.

What has been little noticed, however, are the provisions that would allow modification of existing enforcement actions between a bank and its primary federal regulator.

If a bank otherwise would qualify to take part in the new capital forbearance program, the bank can request a modification of the enforcement agreement with its federal regulator in order to reduce or eliminate its capital requirement.

Enforcement or supervisory actions can be characterized generally as being informal (written agreements or memoranda of understanding) or formal (directives, cease-and-desist orders, terminations of insurance, removals of officers and directors, and so forth). These types of actions are brought by the regulators to correct existing problems and to prevent future problems that could result in the unsafe or unsound operation of a bank.

In many of the agreements, among other requirements, there is a provision for the bank to increase its capital to a certain minimum level within a prescribed period of time.

Both the Federal Deposit Insurance Corp. and the Comptroller of the Currency have announced similar requirements for a bank to qualify for participation in the capital forbearance program. While less specific as to standards and procedures, the Federal Reserve Board also has issued a policy statement regarding capital forbearance for agricultural and energy banks.

Generally, to qualify for the program, the bank must meet the definition of an agricultural or energy bank. With specific approval by its regulator, a bank can qualify for the program if it does not meet the definition of an agricultural or energy bank but its local economy is depressed as a result of problems in these two areas.

It must have capital below the minimum required levels, which condition was not caused by excessive dividend payments or operating expenses, misuse

Capital infusion in a bank can be enhanced significantly by changing the enforcement action to eliminate the time pressure within which new capital must be raised.

of bank abuses, significant mismanagement, or actions taken solely to qualify for the program.

Additionally, the bank must develop a plan to show how it will meet minimum capital levels in the future. Progress reports on implementation of the plan are required. Banks with primary capital below 4% must seek special approval of its regulator in order to take part.

To take part in the program, a qualified bank must apply to the regional office of its regulator prior to Dec. 31, 1987. Its application must contain its proposal to achieve minimum regulatory capital in addition to a statement as to why it is eligible for capital forbearance.

Notification Period

Unless the bank receives a notice of denial or a request for additional information within 60 days of receipt of its application, the bank will be considered to have received capital forbearance by its federal regulator.

An affirmative acceptance by the federal regulator is needed, however, for an application by a bank that has primary capital of less than 4% at the time of application, that does not meet the definition of an agricultural or energy bank, or that seeks modification of an existing enforcement action.

Infusion of capital is a common requirement found in almost all enforcement actions. For a variety of reasons, it is also one of the most difficult with which to comply.

In addition to trying to raise new capital in a short period of time, a bank that is subject to an enforcement action is operating under a cloud. It has been identified as having problems, and, consequently, investors are more reluctant to put new money into a "problem institution" than into a bank that is

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Mr. Brooks is a partner in the Washington, D.C., law firm of Dickstein, Shapiro & Morin. He was formerly general counsel of the Federal Deposit Insurance Corp.

American Banker

Letters to the Editor

The Value of Having a Positive Image

To the Editor:

I must take exception to Dr. Paul Nadler's point of view that a bank's "image" is of no particular importance to the public ["Who Cares About Your Image? Not the Public," May 27, page 4]. True, even the most creative and

the same time period. And, in the hypercompetitive environment of the mid-'80s, just maintaining market share is no small achievement.

I also have to question Dr. Nadler's premise that banks that stress public service also are doing themselves little

Counselor's Corner...

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operating in a safe and sound manner.

Capital infusion in a bank can be enhanced significantly by changing the enforcement action to eliminate the time pressure within which new capital must be raised. If the time limit to raise capital is six months, often that is too short, given the fact that the economic conditions in the community will not change in that period.

However, elimination or extension of that time limit will enable the bank better to reduce its operating expenses and to increase and retain its earnings and generally will give it more time to work its way out of its problem.

Additional time also can allow a bank to explore the market for a merger with, or acquisition by, a healthier institution. Should this course of action be followed, it is to be hoped regulators provide a slightly different treatment regarding capital forbearance for the resulting institution.

The policy of the Office of the Comptroller of the Currency states that it would object to changes in control or acquisitions of such banks unless the transaction will result in prompt restoration of capital to appropriate levels." The FDIC and the Fed policies are silent regarding this matter.

It appears that on a case-by-case basis the FDIC and the Fed will determine whether or not capital will have to be restored immediately upon the acquisition by, or merger of, a bank taking part in the capital forbearance program.

Forbearance in Mergers

One component of a plan for a bank to improve its condition might be to seek a merger or acquisition partner. If allowing some form of capital forbearance to the resulting entity would prove to be the critical element in whether or not a weak bank is acquired by, or merged with, a healthier bank, the FDIC or the Fed might decide that the benefits obtained from allowing a continuation of capital forbearance outweigh any benefits derived from requiring an immediate restitution of capital.

Implementation of the capital forbearance program might not provide a significant amount of relief for banks currently, or soon to be, on the problem bank list. It is restricted to agricultural or energy banks or banks whose problems can be attributed to declines in those sectors of the economy.

Additionally, if a bank's problems are a result of mismanagement, large overhead, or some other factor, the bank might not qualify for the program.

Where a bank does qualify, however, it can buy much needed time to work its way out of its problem or explore other capital raising alternatives.

If a bank is operating under an existing enforcement agreement, should it qualify for capital forbearance, modification of the part of the agreement that requires additional capital within a limited time period can provide much-needed relief and create more opportunities for the bank to return to a healthy financial condition. ■

Marine Will Phase Out Lending, Focus On Capital Markets at London Office

By GORDON E. LIGHT

NEW YORK — Marine Midland Banks Inc. said it has recommended its London branch office to phase out its lending activities and focus primarily on capital markets.

The new general manager effective July 1 is Douglas Lowings, who was previously general manager for the bank's financial markets division in London. He replaces Barton Spencer, who is coming to the United States to work for Marine's metro banking group, which serves the New York metropolitan area.

The London branch's concentration on financial markets will cover, among other sectors, foreign exchange, money market trading and funding services. The branch will be relocated in the London offices of the HongKong and Shanghai Banking Corp., which owns 51% of Marine.

According to Richard C. Keller, senior executive for capital markets, the changes at the London branch reflect the bank's previously announced strategy to scale back its international lending business outside the Western Hemisphere. Much of that lending business will be picked up by Marine's majority shareholder, HongKong and Shanghai, a spokesman said.

"Increased coordination with the HongKong Bank in Europe, the Middle East and Asia is a key element of Marine's international business strategy," Mr. Keller said. "Our new London headquarters will provide Marine with enhanced access to the resources of other London-based HongKong Bank group members involved in capital market activities." ■

First Tennessee Chairman Now a University Trustee

Special to the American Banker

MEMPHIS — Gov. Lamar Alexander has appointed Ronald Terry, chairman of the First Tennessee National Corp., to a nine-year term on the University of Tennessee board of trustees.

Mr. Terry had served two years of a nine-year term on the Tennessee Higher Education Commission, which coordinates state higher education programs. Gov. Alexander asked him to take the university post instead because Mr. Terry's longtime interest in education and medicine coincided with the institution's commitment to strengthening St. Jude Children's Research Hospital in Memphis. ■

This announcement is neither an offer to sell nor a solicitation of an offer to buy these securities.
The offer is made only by the Prospectus.

Mr. BARNARD. Thank you, Mr. Brooks.

Mr. Howard, first of all, how big is the Treasure Valley Bank?

Mr. HOWARD. We're a $90 million bank.

Mr. BARNARD. And located where?

Mr. HOWARD. Fruitland, ID.

Mr. BARNARD. How many banks are in Fruitland?

Mr. HOWARD. One bank.

Mr. BARNARD. Just one bank?

Mr. HOWARD. Just our bank.

Mr. BARNARD. What trade area do you serve then?

Mr. HOWARD. We serve a trade area of several small economic or agricultural towns, and some of those towns are in Oregon, because we are a bedroom town of Ontario, OR.

Mr. BARNARD. What is your capital ratio at this time?

Mr. HOWARD. Our capital ratio as of our January exam was 5.22. Since that time, we have been able to raise it to about 5.7.

Mr. BARNARD. Are the conditions that Treasure Valley Bank is having, is that pretty much indicative of other experiences with small banks in Idaho as far as capital forbearance is concerned?

Mr. HOWARD. I think in the State of Idaho we are pretty typical even of some of the larger banks in Idaho. Of course, there are some exception banks, but right now in Idaho we see the large banks suffering in the same area that we are, and that is in the ag area.

Mr. BARNARD. What capital ratio are they using as a goal?

Mr. HOWARD. They would like to have us at 8 percent.

Mr. BARNARD. That's a noble ambition, isn't it?

What about savings banks? Are they experiencing any forbearance as far as their operations are concerned?

Mr. HOWARD. In the State of Idaho we do not have savings banks, but we do have savings and loan associations.

Mr. BARNARD. What about savings and loans then?

Mr. HOWARD. They're having problems.

Mr. BARNARD. But they're not making the same kinds of energy loans or agriculture loans as the banks are.

Mr. HOWARD. Just within the last few years, because of the deregulation, they have been getting into ag loans.

Mr. BARNARD. Mr. Brooks, I believe you said that you were representing one bank that was seeking to get an application before the FDIC.

Mr. BROOKS. Yes, sir.

Mr. BARNARD. Are you familiar with any other banks, other than that one, that you could say could identify a pattern as far as the FDIC's program is concerned?

Mr. BROOKS. No, sir, I cannot; I just don't have that experience.

Mr. BARNARD. Mr. Howard, I'm certainly impressed with how you have certainly tried to cooperate with the FDIC. That was a very significant step, to remove the management. Had you anticipated making that move before you did so?

Mr. HOWARD. No, we really hadn't, and I must say in this regard, to protect the FDIC, the FDIC did not ask that. They criticized us. We thought, we'll correct that. After we did it—they were astounded that we did it—the assistant regional director came and visited with our board and told them that they sure didn't require it and

that current management was qualified to do anything within the bank.

Mr. BARNARD. Are they still critical of your management?

Mr. HOWARD. No, they aren't.

Mr. BARNARD. But still they have not encouraged you as far as your forbearance application is concerned?

Mr. HOWARD. No, they have discouraged that.

Mr. BARNARD. Have they given any reasons why?

Mr. HOWARD. Not since the other criticism, and I'm sure they feel that we can accomplish—their indication is, they feel we can accomplish the capitalization without the forbearance. We feel it's tough to go into the marketplace with the agriculture climate, which has to be our local towns, and sell our stock. We are broadly held; we have 400 stockholders.

Mr. BARNARD. What are your prospects for growth?

Mr. HOWARD. Well, the prospects for growth are good, with the exception that we have been a growth bank in the past.

Mr. BARNARD. How old is the bank?

Mr. HOWARD. Twelve years. So we've been a very aggressive bank. Obviously, if we had foresight as good as hindsight, and knowing what the economy was going to do, we wouldn't have been a growth bank. We are not a growth bank now, strictly because of the policy of the board and policy of management. We are shrinking slightly right now.

Mr. BARNARD. Mr. Craig.

Mr. CRAIG. Thank you very much, Mr. Chairman.

Mr. Howard, when was the last time you went through an examination?

Mr. HOWARD. January 1986.

Mr. CRAIG. During the time of that examination, you mentioned, at least in your testimony, that the field examiners were tough, and you said "scared to death of the economy." and you mentioned something about "scared of congressional criticism." Could you reflect on that?

Mr. HOWARD. They indicated this to us directly and with statements such as they were going to cover their hind side, and we said, "Well, from whom?" and they said, "Congress."

I think what you have to realize is the examiners are human, just like the bankers are, and this economy has a banker scared to death. I think this economy has the examiners scared to death, and if they are human, they are going to be tougher now than they were 3½ years ago, the last time they were in our bank.

So we saw some difference, just from the human standpoint; they are scared of the agriculture economy. So they were critical, they were tough, they have our attention. We don't like the criticism; consequently, we are changing the pattern of the bank.

My board is an older board of directors, and they're conservative, and so you will find it's kind of like the old story you hear around, if you don't need a loan, you'll get one. Current management and the current board of directors are very conservative in their lending policies.

Mr. CRAIG. Would you agree with the statement that Mr. Brooks has just made, in large part?

Mr. HOWARD. Yes, I think I would.

Mr. CRAIG. Do you agree that there may be some difficulty because of congressional concern on one side because of some major bank failures? And certainly this committee has been involved, as Mr. Brooks has said, in examining the methods by which our regulators have handled or failed to handle that.

Mr. HOWARD. Yes, I would say that's definitely so in that the statements were made to us on a voluntary basis.

Mr. CRAIG. In what respect?

Mr. HOWARD. They do not want to be criticized. They're human, they're just like we are, they don't like criticism.

Mr. CRAIG. Did they mention a Continental or a Sea First or something like that in their conversation?

Mr. HOWARD. Yes, they did.

Mr. CRAIG. They actually mentioned it?

Mr. HOWARD. Yes.

Mr. CRAIG. As being their concern and why they were going to be the way they were with your bank?

Mr. HOWARD. Sure. They were criticized for not being thorough enough in the past. Consequently, I think you'll find the regulators being very thorough. When they come into a bank, they look at every loan, and if there's a question, I feel the loan is classified.

Mr. CRAIG. So once the examination was over, and as the directives came down in March, and you felt your bank qualified for application into capital forbearance directive, you called San Francisco?

Mr. HOWARD. No. They have called us on our application.

I might say that I feel they have been extremely cooperative in every area, with the exception that they don't feel we should have the Capital Forbearance Program.

Mr. CRAIG. What was their first reason for suggesting that you should not apply?

Mr. HOWARD. Management. They felt it was a management problem, because of the classified loans.

Mr. CRAIG. Because of your concern for application and that criticism, you, the board, decided to voluntarily change management.

Mr. HOWARD. I made that decision, and went to the board, and convinced them of it.

Mr. CRAIG. Since that time and your correspondence in relationship with San Francisco, their approach has not changed?

Mr. HOWARD. No, their approach has not changed. They have visited with our new CEO, they have told him they like his attitude, they like the attitude of our board of directors, and they don't think they're going to have any problems at all, and they also feel that we have the capability of raising the capital. We see the marketplace as a little negative, but we're going to try.

Mr. CRAIG. So if you cannot qualify for or gain a capital forbearance policy with the FDIC, your alternatives then would be to raise capital?

Mr. HOWARD. Yes, and we will try to raise capital the best we can. I don't believe we can meet their schedule, but I think we can get it done. But their schedule is fairly short.

Mr. CRAIG. How much capital are you going to have to raise?

Mr. HOWARD. We need to raise over $2 million.

Mr. CRAIG. And where would you raise that capital? Where would you look for it?

Mr. HOWARD. We would go to our existing stockholders and customers, is the only place we see where we could raise it.

Mr. CRAIG. In other words, in Idaho.

Mr. HOWARD. Yes.

Mr. CRAIG. If you were granted capital forbearance, what would you be able to do at that point, or what would the bank be able to do differently than it's doing today?

Mr. HOWARD. Well, I think it would let us concentrate more into the loan portfolio and with the classified loans and give us more room then to work out the capital program.

In the capital forbearance, we have submitted an application to them, and we have approached the new capital from several different facets. It gives us a 5-year program, and we've given the schedule on how we will raise it.

Mr. CRAIG. In other words, instead of concentrating on raising capital, it would give you an opportunity to deal more with the borrower?

Mr. HOWARD. Yes, it would, and give us more time. We have to concentrate on capital, but it would give us a lot more time to do a better job of it, and of course hopefully in a 5-year period we won't see this economy right through the 5 years; we hope for an upturn.

Mr. CRAIG. How many of the loans that you have classified today were not classified or would not have been classified a year or two ago?

Mr. HOWARD. I really can't give you that number, but I'm sure it's different, strictly again from the fact that I think the examiners are more conservative. I'm not saying that they have a directive to be more conservative; I don't know that. I think from the fact they're human, they see what's going on in the economy, and I think it's a natural process to be more conservative in this climate. I am, and I'm sure they are.

Mr. CRAIG. Would you say that the loans that your bank made 2 to 5 years ago in agriculture were considered bad loans at the time?

Mr. HOWARD. No, I don't think so. I'm telling you, Congressman, that our bank 5 years ago would take a young man off the farm, and if we felt he was moral, that he was ethically sound, that he had the farming skills, but he lacked capital, we would go with him, and we have some real success stories.

Today, that is not true. We want him to have everything—the margin on the cash flow, we want him to have the capital, and the only exception we make to that is, we are an approved lender of the Farmers Home Administration, and the only exceptions we make are with the 90 percent Farmers Home guarantee.

Mr. CRAIG. Here is a statement I received from one of your fellow bankers in Idaho, and I would ask if you would concur in it. He talks about the situation and the change and what are now viewed as poor lending practices that equate into determinations of "bad management by FDIC examiners." He said, "To explain that statement, until 2 years ago nearly all banks were evaluating and making loans based on asset lending. Today, criteria refers only to

cash flow and gives little consideration to assets unless they are completely liquid, such as a U.S. Government bond."

Mr. HOWARD. I agree with him, and I've got to tell you that the bankers in Idaho have turned to cash flow lenders. I don't know of any of them today that are not cash flow lenders.

Mr. CRAIG. Do you believe Federal regulators have brought about this change?

Mr. HOWARD. Not 100 percent. I think through the economy and so forth the bankers have woke up that they have to be cash flow lenders.

Mr. CRAIG. But those practices that we just discussed as to lending were not considered bad management practices.

Mr. HOWARD. That's right.

I think that, generally speaking, bankers for many years, the first thing was the collateral involved. I must say that I think the bankruptcy court has helped to change the bankers' attitude from collateral to cash flow lenders also.

Mr. CRAIG. The point I'm leading to is a question of management, what is or is not good management. How that is viewed by the FDIC or OCC examiner, and in the consideration of providing capital forbearance one of the considerations, of course, is management. Obviously, in your instance, they've made that consideration and have discouraged you from making application because of that. You've recognized that. Based on their reaction, you've made an effort to change that. Your board apparently has responded in the positive.

I guess my next question is, How do you determine bad management in these kinds of economic circumstances? Was your bank viewed 3 years ago as being badly managed by the FDIC?

Mr. HOWARD. No, and I think it absolutely has to be an arbitrary decision. Again, there are human people involved, and one man would sure call it different than another.

Mr. CRAIG. And obviously call it different now that some of those loans that were good loans have gone bad.

Mr. HOWARD. Absolutely.

Mr. CRAIG. In other words, could you say that the management call being made at this moment as a consideration of capital forbearance by the FDIC is one based on an anticipation that there was phenomenal hindsight and foresight involved at the time the loans were made?

Mr. HOWARD. I think so.

Mr. CRAIG. Because of your need now to become more conservative as a bank, you said even with the potential shrinking of the bank itself, in your estimation, how will you view the communities in which you operate as a banker today?

Mr. HOWARD. I think as a banker today we would rather be criticized for not serving the community than we would be criticized because we have too many classified loans, and we may be criticized in that area some day, but we'll take that criticism. We absolutely are going to be conservative as a bank.

Mr. CRAIG. In other words, you are saying that your policy for banking today and the way you treat the borrower and the community in which you serve is a dramatic change from the way it was.

Mr. HOWARD. Absolutely.

Mr. CRAIG. How do you feel about that?

Mr. HOWARD. I'll have to tell you that, being a salesman type personality, I enjoy growth and building something, but I've got to tell you that I absolutely support the policy of the board to make that change. I think once you go through these times it happens to you, and I've never understood the bankers who have been my friend, who have been through the Depression, and their conservative, negative attitudes, and today I have a new understanding of those people.

Mr. CRAIG. What is the end result in the community of a State like Idaho or any other State that has a banking community that now holds the view that you hold?

Mr. HOWARD. I think it's devastating, and I don't have the answers, but we've got to remember that these people have a lot of problems in agriculture, and then we've added one more problem, and that is a bank that is conservative, and I don't think it's only us.

I think also the Farm Credit System has really been burned, and you'll find those people have moved over to very strong conservative positions. So I think it compounds some of the problems these people have. I don't have the answers to help them, of course.

Mr. CRAIG. How has FDIC viewed commercial loans made to, for example, implement dealers or other ag-related businesses which have fallen behind?

Mr. HOWARD. I don't think they view those any different. I think it's either a credit they'll classify or not.

What you have to remember is, in our towns, there are businesses that are not agriculture-related, such as a furniture store or a hardware store. But if they are depending 70 percent on the farmers to buy their products, they are really agriculture-related, but it doesn't show, of course, on the statement of conditions.

Mr. CRAIG. And they don't view them as ag-related.

Mr. HOWARD. No, no. Both are commercial loans.

Mr. CRAIG. Those are considered commercial.

Mr. HOWARD. Right.

Mr. CRAIG. Mr. Brooks, the bank which you are currently representing which is applying for capital forbearance, are they familiar with FASB 15, and, if so, are they using it?

Mr. BROOKS. Yes, sir, they are, and they are in the process of using it. They are only recently familiar with it, quite frankly, as a result of the capital forbearance policies. It's a smaller bank, about the same size as Mr. Howard's, and they just were not that aware of the use of FASB 15 prior to this policy being announced.

Mr. CRAIG. Do you think the FDIC should make banks more aware of FASB 15 prior to possible Senate action?

Mr. BROOKS. As I understand FASB 15, it has been on the books for years, and it has been available for those who have wanted to use it, but it is my understanding that the smaller banks really were not that aware of FASB 15. Larger banks and their accounting firms were, and I'm not sure to what degree use of it was made.

Mr. CRAIG. In other words, you are suggesting that it has been there for a length of time, as we are well aware, but there has been no effort on the part of the FDIC to suggest this as a tool.

Mr. BROOKS. I don't think there has been that effort to suggest it as a tool. I don't know that they have been negative about it. I think it's really been rather a silent situation.

Mr. CRAIG. Something available if you could find it.

Mr. BROOKS. Sure.

Mr. CRAIG. Out of all of the proposed ag bank relief legislation that was before the Senate earlier this year, do you believe the capital forbearance policy was the best designed to temporarily assist ag banks?

Mr. BROOKS. I think it makes a lot of sense. I'm not familiar with every piece, obviously, of the legislation that has been proposed or other proposals.

If one can see light at the end of the tunnel, if one is in a fairly good capital position, like Mr. Howard's bank—5 percent is below minimum regulatory levels, but it's not 2 percent, or 1 percent, or even 3 percent—and if you think that over time you can deal with your problems but it will not work out overnight—and to require one to raise their capital $2 million is not a small amount in a town the size of Mr. Howard's, and that could be very difficult.

If you go to the marketplace and tell your local community you want to raise capital, and if your success depends on whether or not at that time you are subject to an enforcement action, this also would make a difference as to your ability to raise capital.

Where you have earnings that are flat or a bit negative, where you have had to write off some of your loans against capital so that your capital is reduced, it's difficult, and it may not be able to be done in a 6-month period of time. But, it may be able to be done over a 2- or 3-year period of time, and if the regulators and the bankers agree that the problem can be worked out, it's just like a problem loan that you have to work out.

Mr. CRAIG. In other words, you set a timeframe, you set a course of action.

Mr. BROOKS. That's right, and in that sense I think the policy is very good, because it gives the regulator and the bank some flexibility to deal with the problem. The alternative is to write down against capital, bring an enforcement action, make sure that that's complied with, and get tougher and tougher if you don't comply with the enforcement action, and that gets you deeper and deeper into the hole. It's not easy in this day and age.

Mr. CRAIG. In other words, would you agree with Mr. Howard that without a capital forbearance policy, where you had to concentrate on raising capital, that it would, in large part, tie your hands to do other kinds of things that might be good and necessary to do in the bank to keep it stable and also serve the public it was addressing?

Mr. BROOKS. It's one other thing that you have to be concerned about, and I'm not sure to what degree one has the ability to do all these things or not. Certainly working with the borrowers and trying to work out some of these loans is very, very important, and that's very time consuming.

I'm not so sure that you couldn't attempt to raise capital at the same time and do other things if you had this particular provision in place. Where you don't necessarily have to go to the capital

market right at that moment, then you could concentrate on other things.

But bear in mind that you have to have a business plan that shows how you are going to achieve minimum regulatory capital over a period of time. It may be 5 years out, but you have to develop that, and it has to be based on some reasonable projections.

So in that sense, the more time you can concentrate on your particular problems, the better it is, obviously. But you are going to have to develop a plan, which I think is a reasonable approach.

Mr. CRAIG. The bank that you are currently working with now, have they approached FDIC yet?

Mr. BROOKS. They have not approached FDIC yet for this particular purpose. They have worked with FDIC in attempting to improve their condition, but they have not come forward. They are currently under a supervisory agreement with the FDIC.

Mr. CRAIG. So there has been no initial inquiry as to their potential success in application——

Mr. BROOKS. Not as yet.

Mr. CRAIG. Thank you.

Thank you, Mr. Chairman.

Mr. BROOKS. I would only add one comment. A real key element in this program, as has been talked about—and I think you hit it right on the head, Mr. Craig—is the management problem, the management question. There is a tremendous amount of discretion with the FDIC in this particular area, as perhaps there should be, and it would be interesting to see what they have to say.

It's a really difficult thing to try to have objective criteria set to determine what is good management and what isn't good management, especially when you are dealing with a bank that has some problems. By definition, if you have got some problems, some could easily say, "Well, you've got bad management." It's not necessarily the case, but it makes it easier——

Mr. CRAIG. You're telling us it's an arbitrary——

Mr. BROOKS. It makes it easier for FDIC or the OCC or the Fed, if they want to, to use a poor management element to block approval of any kind of participation in a program, because it's hard; it's very hard to determine. I'm not an examiner, and I've never been, so I can't really speak to that, and I don't think that their job is easy, by any means, but it's a hard situation and one that they have a lot of discretion in, in that sense.

Mr. CRAIG. Thank you.

Mr. BARNARD. Mr. Spratt.

Mr. SPRATT. Thank you, Mr. Chairman.

Mr. Howard, I was president of a small community bank. My grandfather was the president of a bank which failed in the Depression because the farm community around him failed, and his farm suppliers and farm implement dealers who borrowed money from him couldn't pay it back. I know the downward spiral in which you are caught. I didn't see it happen, but I've lived with the stories of it for all my life.

Let me ask you a few questions, some of which you may not be able to answer because they may be confidential or related to the examination and therefore not disclosable.

Mr. HOWARD. Sure.

Mr. SPRATT. Your actual equity is about $4 million, to $5 million?

Mr. HOWARD. It's over $5 million, yes.

Mr. SPRATT. It's over $5 million, and that's stated capital and retained earnings, by and large?

Mr. HOWARD. Yes. They do not count debt capital any longer; that's a new change. So it's all equity capital and retained earnings.

Mr. SPRATT. What is the size of your loan loss provision now?

Mr. HOWARD. After the examiners left, it was down to about $450,000, which strained it. That's low.

Mr. SPRATT. That's low.

Mr. HOWARD. We're building it back, yes.

Mr. SPRATT. So in relation to your actual potential losses, that's not an overstatement of the loan loss provision?

Mr. HOWARD. No, it isn't.

Mr. SPRATT. You don't have any potential equity in the loan loss provision.

Mr. HOWARD. No.

Mr. SPRATT. Do you have any real estate owned or other repossessed collateral that has been charged off that potentially could represent some potential recovery?

Mr. HOWARD. Yes, we do have.

Mr. SPRATT. Does that amount to anything? Do you get any credit——

Mr. HOWARD. Yes, they will give us credit on anything we recover, loans or real estate, and we have had real estate problems in Idaho. However, our real estate—other real estate owned is improving, it's down from where it was a year ago, and right now the market is good on real estate.

Mr. SPRATT. The question I'm driving at is, will the FDIC give you any kind of allowance for REO, other repossessed collateral that has been charged off, some sort of recovery potential that is a potential add-on to your capital accounts?

Mr. HOWARD. No. What they are willing to do is to give us credit for the courses we liquidated.

Mr. SPRATT. As you liquidate and recover.

Mr. HOWARD. Sure, and they've got the pressure on us to finish liquidating it, and they should, and that's coming along very nicely.

Mr. SPRATT. Can you put a dollar value on the potential recovery value of those assets that you have repossessed but aren't carrying on your books?

Mr. HOWARD. It's really hard, because we are selling things below appraisal value in Idaho.

Mr. SPRATT. What about reappraisal equity on the real estate and other assets that you own? Do you have value to your real estate assets——

Mr. HOWARD. Yes, we have——

Mr. SPRATT [continuing]. Operating assets?

Mr. HOWARD. Yes. I can tell you're a banker, the way you're looking at these things.

Yes, there is, and very fortunately the bank owned all of our real estate, we did not rent, and so we have built some excellent equity in there, and then through the years, of course, we have depreciat-

ed on top of it, and we are securing new appraisals on that, and we think we're going to be able to submit a very attractive plan to them in that area.

Mr. SPRATT. I know banks can't create an account called reappraisal equity, but at least you could come up with an alternative balance sheet for the FDIC to deal with which would identify this potential value in your banking firm. Are they willing to recognize the value of—the surplus value over book of your real estate assets?

Mr. HOWARD. I don't think they are. However, we are going to present to them a plan to see if they will buy it in moving our real estate to the holding company, which we already have in place, and being able to then put some capital in the bank from those equities.

Mr. SPRATT. Do you see any potential of selling it, leasing it back, or is that what you're going to do?

Mr. HOWARD. Yes.

Mr. SPRATT. You're going to sell it——

Mr. HOWARD. We sell it to the holding company, get a loan for the holding company, and lease it back.

Mr. SPRATT. What percentage of your assets is nonperforming?

Mr. HOWARD. I don't know if I should disclose that right now.

Mr. SPRATT. That's all right. I understand.

Mr. HOWARD. I don't have the percentage in my——

Mr. SPRATT. OK.

As I understand what you are saying, your reluctance, however, to go for new equity is that you really don't want to dilute the ownership interest of your present shareholders or at least of the customer base that has patronized the bank.

Mr. HOWARD. No, that does not bother us one bit. We're broadly held. The man who has the largest equity in the bank is close to 10 percent, and because of his age, he's going to start giving that away to a nonprofit organization. So we don't have any hangups with that. We just know that the marketplace is broke, it's a lousy time to sell bank stock, so that's our problem. But we have no problems in diluting the current ownership.

Mr. SPRATT. And selling outside the community where you live?

Mr. HOWARD. That would not bother us either.

Mr. SPRATT. No problem?

Mr. HOWARD. No problem.

Mr. SPRATT. I'm sorry, I misunderstood what you said; I thought that was one of your hesitations.

Mr. HOWARD. No. It's just the fact that we know—I have personally sold all of the stock myself that was sold to capitalize the bank. I started the bank—started working on it in 1973. So I have been out there several times selling stock, and I know when I can sell it to the community and when I can't, and it's not there today.

Mr. SPRATT. What I'm groping for is what the problem is. I mean, 4 to 5 percent doesn't shock me—4 to 5 percent equity ratio doesn't shock me too much in today's world. It's too bad you didn't make your loans to Third World farmers instead of Idaho farmers.

Mr. HOWARD. That's right.

Mr. SPRATT. The FDIC might tolerate your equity ratio.

Mr. HOWARD. I've got to say that we're still a viable bank, FDIC says that, and FDIC is working with us, and we're going to be able to cure this farm thing.

The only gripe we really have—at this point, you know, the directors are blaming themselves, they're not blaming the FDIC. The only thing we're saying is, why in the world can't we have a 5-year program to do it instead of a 12-month program? I think we could do a better job. The program is there, but it seems to me like they are not even thinking it through. They've just made a decision that we can do it otherwise, and that's the problem.

Mr. SPRATT. Well, I wish you luck in turning it around.

Mr. HOWARD. Thank you.

Mr. SPRATT. Thank you.

Mr. BARNARD. Mr. Howard, how long would you say that you've been in this posture with agriculture problems? In my evaluation, it's somewhat different than the energy bank problem, because the price of energy dropped so drastically, so quickly, but in my part of the country we've been wrestling with farm problems now for many, many, years, so the forecast was there.

So the question is, how long has your bank felt that they were in a problem loan position with agriculture?

Mr. HOWARD. Two years. Prior to that, of course, there were some problems. We've got a total of five cattle ranches—cow/calf ranches—and there isn't a cow/calf ranch in Idaho that's any good.

But the reason I say the last 2 years is, Fruitland sits in the middle of the onion capital of the world; we produce more onions there than anywhere else, and the last 2 years we've had horrible prices. Last year, we dumped a big part of those onions.

It's like playing the roulette wheel to raise onions. It's a tough one. You can't contract them. We're in a community that is very heavy in a Japanese community, and those guys are the best row croppers in the world. Consequently, we have a lot of onions. Thank goodness we've got some sugar beets and some staple crops, too, but this has hurt our market.

Mr. BARNARD. The FDIC, in suggesting management changes, have they suggested that maybe some of these problems could have been foreseen?

Mr. HOWARD. I think, in some of their criticism of supervising the branches, we had one branch that had more than its share of some problem loans with a fairly new manager, and it took us a little while to catch up with that. We caught it before FDIC was there, but they felt we should have caught it the first 15 days instead of the first 12 months. I don't know how we defend ourselves. We accept that type of criticism.

However, I've got to tell you, one of the major banks has a branch on each side of us that are without managers, and exactly the same thing happened in those branches, too. So you just tighten your control, tighten your supervision, when this happens. But they were critical of us in the one branch.

Mr. BARNARD. Having some expectation that there could be a possibility of forbearance, from the FDIC have you exercised any forbearance in your own policy toward your customers?

Mr. HOWARD. Yes, in several ways. I've got to tell you, we've done more of it since we've been able to secure the approved lender

status through the Farmers Home Administration, because we can do this. It's a good program, and one thing we have found is, FDIC will give us an automatic—take them off the classified list when we get that guarantee.

We try to be realistic with those. We don't want to take loans with no chance there, but loans who need a 10-year, a 15-year term, perhaps with a second on the real estate and it cleans the loan up, we go on that.

Mr. BARNARD. My final question is, has the Idaho Bankers Association taken any official position as far as forbearance is concerned so that, in other words, you wouldn't be just representing your own individual bank this morning but also other banks throughout Idaho that are having the same problem?

Mr. HOWARD. No, they have not taken a position.

Bank problems are interesting. Bankers seem to not like to talk about it. It's amazing when we wake up that another bank has the same problem as we have. It's an interesting thing. They do not share well, they keep this thing confidential, but they probably should work more to help each other in that area.

Mr. BARNARD. Mr. Brooks, is the situation that we have identified with Mr. Howard this morning pretty general, or is it isolated in particular areas? Do you have enough knowledge on that?

Mr. BROOKS. I could only speculate on that, Mr. Chairman.

I think the kind of situation in which Mr. Howard finds himself and his bankers is probably fairly common. Where you have some bad loans, the examiners come in and they see that, they reduce your capital accordingly because they require you to write it down, and then you have to come up with additional capital, and how do you do it? It's sometimes not very easy to do in a short period of time. You think you're strong and solid, but it's hard to work it out over a quick period of time.

Mr. BARNARD. In the area of management, would you think the problem with the energy banks is more easily understood than the problem with farm banks?

Mr. BROOKS. I don't think so. The energy banks had a real hit this spring, as oil prices dropped rapidly, and that caused some problems, but people have seen that coming for the last 2 years as prices have gone down.

Usually it's found in the Southwest where you also have a lot of agriculture lending as well as energy lending, and so banks sometimes are doubled up and maybe harder hit in Oklahoma, Texas, Louisiana, and New Mexico, and places like that, versus Nebraska, Idaho, or Montana, where it's pretty much exclusively agriculture. But I think they are seeing similar kinds of problems and having a difficult time dealing with them as well.

There are a lot of salvageable institutions out there that, I think, because of the economy, are having temporary declines. The big question is, how do you deal with them?

Mr. BARNARD. Gentlemen, you certainly have set the stage for a very interesting hearing this morning. I must say, I compliment both of you on your testimony and also your attitude. You have been very respectful of the role that the Comptroller plays as well as the FDIC and the tremendous responsibility that they have to provide our country with safe and sound banking. At the same

time, we don't want our communities of the country not served by the banking industry.

So it looks to me like we do have a rather sensitive problem, and I think it's time that we now hear from our regulators.

Do you have any further questions, Mr. Craig?

Mr. CRAIG. No, I don't, but I thank both Mr. Brooks and Mr. Howard for their candid testimony.

I would have to concur with my chairman that we appreciate your respect of the regulatory process, we understand its need, its necessity, to assure America of a safe and sound banking system, and I do think you have set the stage, because we do have difficulties that mutually can be worked out, but it has to be a mutual effort.

Thank you very much.

Mr. HOWARD. Thank you.

Mr. BARNARD. Mr. Spratt.

Mr. SPRATT. No, thank you.

Mr. BARNARD. Thank you, gentlemen.

Mr. BROOKS. Thank you.

Mr. BARNARD. We would now like to hear from Mr. David Meadows, Associate Director of the Division of Bank Supervision of the FDIC, and Mr. John F. Downey, Chief National Bank Examiner.

Gentlemen, we again appreciate your cooperation in being with us today. You are getting to be a good source of information for this particular committee. We have scheduled you now about once a month.

I was rather interested this morning to see that our reputation—that is, the reputation of this committee—is getting to be known far and wide. It's even gotten down to Idaho, where they are very mindful that we have been——

Mr. CRAIG. We bow to you, Mr. Chairman.

Mr. BARNARD. Not me. This is the committee working, you know.

But I would say that we have been, I think, very astute in our oversight of the OCC and the FDIC, as well as the FSLIC and the Home Loan Bank Board, and the problems that you have had regulating and supervising banks. So don't say that we're not sympathetic with the role that you have; we're very sympathetic with this problem that we have with us today.

Gentlemen, without objection, we will include your entire testimony in the record, and we will hear from Mr. Meadows first and then Mr. Downey. If you would care to summarize, we will leave it to your judgment.

STATEMENT OF A. DAVID MEADOWS, ASSOCIATE DIRECTOR, DIVISION OF BANK SUPERVISION, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. MEADOWS. Thank you, Mr. Chairman and members of the committee.

I would like to briefly summarize my statement in the interests of time.

It is a pleasure to be with you this morning to testify on the FDIC's implementation of its capital forbearance policy. Capital forbearance, however, is only one facet of the regulators' program

to aid banks. The program is a package with the parts designed to complement one another.

In addition to capital forbearance, the other aspects of the program are, we encourage the appropriate use of Financial Accounting Standards Board Statement No. 15 which has been mentioned earlier—that is, FASB 15—in accounting for the restructuring of loans to troubled borrowers. This accounting opinion permits banks to modify the terms of the loan, including forgiveness of principal and/or reduction of the interest rate, and not recognize the loss so long as future contractual payments of principal and interest specified by the new payment terms equal or exceed the amount of the loan on the bank's books before restructuring.

Second, renegotiated loans were removed from the definition and schedule of nonperforming assets disclosed in quarterly call reports filed by all banks. This change recognizes the reality that the chance of repayment on a restructured loan may well be greater than before the restructuring, and the loan would be considered performing as long as the borrower meets the new terms.

Finally, the regulators have several times reaffirmed the policy—and I think this is very important—the policy of not criticizing a bank's practice of forbearance with individual borrowers as long as such forbearance is consistent with safety and soundness.

While we are willing to work on a cooperative basis with agriculture, energy, or other banks experiencing hard times, I think it should be noted that those institutions which have been mismanaged or have been engaging in unsafe or unsound practices can expect vigorous supervisory activity from the FDIC.

That concludes my oral statement. I'll be glad to answer questions after Mr. Downey finishes.

[The prepared statement of Mr. Meadows and letter responding to subcommittee questions follow:]

STATEMENT ON

IMPLEMENTATION OF CAPITAL FORBEARANCE

PRESENTED TO

COMMERCE, CONSUMER, AND MONETARY AFFAIRS
SUBCOMMITTEE
of the
COMMITTEE ON GOVERNMENT OPERATIONS
UNITED STATES HOUSE OF REPRESENTATIVES

BY

A. DAVID MEADOWS
ASSOCIATE DIRECTOR
DIVISION OF BANK SUPERVISION
FEDERAL DEPOSIT INSURANCE CORPORATION

JUNE 17, 1986
9:30 a.m.

Mr. Chairman, the FDIC shares the committee's concern with the condition of the agricultural and oil and gas sectors of the economy. We have experienced a sharp increase in the number of failed banks in recent years, especially so with agricultural banks. There were only seven failures of agricultural banks in 1982 and another seven in 1983. In 1984 that number had jumped to 25 and increased again in 1985 to 62. So far in 1986 there have been 23 failures of agricultural banks. Though energy bank failures have not been as numerous, the deterioration in that economic sector over recent months from an already weak position has placed a significant strain on financial institutions operating in areas dominated by the oil & gas industry.

As a result of our concern, and after consultation with Congress, the three federal bank regulators adopted a program to assist banks in their attempts to work through the present period of weakness. Today, I will discuss the initial results of the program as it has affected the state nonmember banks under FDIC supervision.

The subject of these hearings is Capital Forbearance but that is only one facet of the regulators' program to aid the banks. The program is a package and the parts are designed to facilitate one another. In addition to capital forbearance we encouraged appropriate use of Financial Accounting Standards Board Statement 15 (FASB 15) in accounting for the restructuring of loans to

troubled borrowers. The principal thrust of this opinion is that banks can modify the terms of a loan, including forgiveness of principal and/or reduction of the interest rate, and not recognize a loss so long as the future contractual payments of principal and interest specified by the new repayment terms equal or exceed the amount of the loan on the bank's books before restructure. As a final element of our package, renegotiated loans were removed from the definition and schedule of nonperforming assets disclosed in quarterly call reports filed by all banks. This reporting change recognizes the reality that the chance of repayment on a restructured loan may well be greater than before the restructuring, and, so long as the borrower is meeting the new terms, the loan is performing.

The FDIC notified the Chief Executive Officers of all insured state nonmember banks of the details of capital forbearance in a Bank Letter dated March 27, 1986. A second Bank Letter dated April 11, 1986 dealt with the specifics of FASB 15. We have made a variety of additional efforts to communicate with the industry in addition to mailing out the bank letters. In Kansas, Nebraska, Iowa, Colorado, Oklahoma, and Texas our personnel have given a total of 17 seminars or presentations on capital forbearance. Some of them were joint with the Office of the Comptroller of the Currency and the respective state bankers associations. Video and audio tapes of these seminars have been made available to bankers in some states through the bankers associations or other private groups. We would estimate that between 1,500 and 2,000 bankers have seen these presentations on capital forbearance and FASB 15.

In order to insure that the policy was understood and consistently implemented in the field it was thoroughly discussed at several meetings among senior management personnel of our Washington headquarters and our Regional Offices. We have also developed standard operating procedures which are followed by all Regional Offices in dealing with capital forbearance.

As of March 31, 1986, there are approximately 2,700 state nonmember banks that meet the definition of an agricultural bank based on the loan volume test (Agricultural loans greater than or equal to 25 percent of the total loans). Of these banks, only 37 report capital ratios between 4 and 6 percent. Another 6 banks show capital between 3 and 4 percent and 2 banks have capital below 3 percent. It is not surprising than that only 37 state nonmember banks have applied for forbearance to date. The program provides that upon application, participation will be granted unless the FDIC denies the application or requests additional information within 60 days. It is only just slightly over 60 days since the program was implemented. Also the banks have until year end 1987 to request capital forbearance. It is only normal under these circumstances for a bank to delay decisions regarding participation, especially since many banks may need time to assess their capital position given the potentially positive impact of using FASB 15.

Also, as we have consistently said over past months, agricultural banks, in spite of significant recognized problems, remain among the strongest capitalized banks in the industry. What exists are farm banks with significant volumes of loans which may need to be restructured and/or may

result in a loss to the bank in the future depending on the strength of the farm economy over the next year or so. For many troubled farm borrowers, 1986 may be a critical year for determining their continuing viability. However, it will often be late fall or early winter before crops are harvested and sold. Until the crop cycle is complete for 1986 and the financial condition of farmers and the resulting impact on banks is determined, the possible need for capital forbearance will not be known. It may be well into 1987 before significant numbers of banks feel the need to apply for forbearance. Therefore, though it is important that we monitor progress, it is too early to make reasonable judgments regarding the program's effectiveness.

There is no reporting mechanism to identify oil and gas loans and therefore it is not possible to determine how many banks meet the loan volume test for capital forbearance. We did conduct an informal survey of our Regional Offices in an attempt to develop an estimate of banks which had significant exposure to oil and gas loans. The survey identified roughly 200 state nonmember banks but many of these did not have enough loans to meet the 25 percent test for capital forbearance.

Using the numbers of banks qualifying under the loan volume test and the numbers of banks below regulatory minimums for capital is not a complete measure of the program's impact. Our policy provides that any bank, regardless of the loan volume test, may obtain capital forbearance if they can support a case that the bank's financial problems are primarily due to adverse conditions in the agricultural and/or oil & gas sectors of the economy. This

would probably cover many of the 200 odd banks disclosed in our energy survey as well as any bank whose borrowers' jobs or business prospects have been hurt by the ripple effect of the weak agricultural and/or oil & gas sectors of the economy. Losses on loans to such borrowers may be a direct result of the weak economy even though the loans do not meet the definition of agricultural or oil & gas loans.

In addition most agricultural banks have enjoyed high capital ratios for many years. It has been a concern among these banks that the regulators would require that these high levels of capital be continued regardless of the economy. Bankers therefore reportedly were hesitant to restructure troubled agricultural credits and/or to take losses on loans for fear of the regulatory response to the adverse impact on capital. Our forbearance policy should have relieved some of this fear by publicly announcing that the regulators recognize the problem and are willing to permit for several years capital well below levels most banks have traditionally maintained. Also the ability to use FASB 15 should reduce the impact of loan restructurings on capital and further remove some of the hesitation bankers may have had to restructure and work out loan problems with borrowers who have a reasonable chance to recover. Until we gain more experience with this program it is not possible to measure the effect, or know, of decisions that have been made differently than otherwise would have been made due to the announced regulatory policy.

The program cannot and was not intended to keep insolvent banks or insolvent borrowers in business. It is recognized by most observers that the problems

in the agricultural and energy economies are so serious and have lasted so long, especially in agriculture, that some banks and even more farmers and energy businesses are unfortunately beyond help and will fail. As painful as this process can be, such failures are one of the ways the economy adjusts to changing conditions so that it can remain strong and viable. Our policies of capital forbearance, use of FASB 15 and reporting for renegotiated debt are intended to cushion, not prevent, this natural process by providing banks with the maximum flexibility possible in their credit and other bank management decisions and not burden them with unnecessary concern over the attitude of bank regulators. Given good bank managers and capable farmers and energy businessman, such decisions should work out to the long term advantage of all parties.

Thank you. I will be happy to respond to questions.

FEDERAL DEPOSIT INSURANCE CORPORATION

OFFICE OF THE CHAIRMAN

June 16, 1986

Honorable Doug Barnard, Jr.
Chairman
Subcommittee on Commerce, Consumer,
and Monetary Affairs
Committee on Government Operations
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Barnard:

Your June 3, 1986, letter asked a series of questions regarding the implementation of our program of capital forbearance and requested FDIC testimony on the subject. I have asked Associate Director Meadows to appear before your subcommittee on my behalf. Following is the requested information.

> Questions 1 through 4 covered statistics regarding the number of eligible banks, applications, approvals, denials and the reasons for denials for state nonmember banks in each of our regions.

As a matter of confidentiality we have made a practice of not disclosing geographical breakdowns of data which may inadvertently lead to identification of an individual bank. Therefore we are providing the data requested in the aggregate.

Forbearance Applications as of June 6, 1986	
Approvals	0
Denials	1
Pending	31
Withdrawals	2
Other	3
Total	37

Agricultural Banks March 31, 1986	
Total number	2666
With capital ratios of 4 to 6%	37

Oil & Gas Banks December 31, 1985	
Total number	200
With capital ratios of 4 to 6%	32

The one denial was to a bank with a capital ratio of only 1.5 percent, well below the 3 percent minimum provided for in the program. Failure was anticipated in the near term. No other applicants had capital ratios below 4 percent. After discussions with the Regional Office, one application was withdrawn because the bank was improving and had nothing to gain from

forbearance. The other withdrawal resulted from discussions indicating that loan problems were not primarily related to agriculture or oil and gas and mismanagement was evident. In the three "other" cases the banks' capital already exceeded regulatory minimums and forbearance was not needed. These banks can reapply if future capital deterioration warrants it.

All applicants met the definition of an agricultural/oil and gas bank except for one. That application is based on recreational real estate loans to borrowers in the agricultural or oil and gas business.

There is no reporting mechanism to capture oil and gas loans. The numbers provided are from an informal survey taken earlier in the year and represent an estimate of nonmember banks which have concentrations in the energy industry. It is doubtful if many of these would meet the 25% loan volume test, however, many could probably readily support the contention that their financial problems are directly or indirectly a result of the weak oil and gas sector of the economy which would be sufficient for admission to the program.

5. What does acceptance into the capital forbearance program actually mean? What would otherwise be the supervisory measures imposed on these banks due to their reduced capital levels?

Acceptance into the capital forbearance program means the FDIC will not take administrative action to enforce normal capital standards as established in 12 CFR Part 325. Administrative actions are generally in the form of a cease and desist order issued under Section 8(b) of the FDI Act or an informal Memorandum of Understanding which will contain provisions addressing capital. In addition, the International Lending Supervision Act of 1983 authorizes regulatory authorities to issue a Capital Directive, which is the legal equivalent of a final cease and desist order, requiring specified action by the bank regarding capital. While administrative actions to address inadequate capital are not taken automatically they are not an uncommon response to a bank's capital problem. The effect of forbearance is that banks will not be faced with these supervisory efforts to obtain increased capital and will be given a much longer period of time (up to 1993) to restore capital than would otherwise be the case.

6. How, specifically, is the capital forbearance program intended to assist the loan customers of the affected banks and the communities within which they are located?

Capital forbearance is only one part of the program for agricultural banks. The Joint Statement of the federal bank regulators on Regulatory Policies Toward Agricultural Lenders also allowed and encouraged appropriate use of Financial Accounting Standards Board Statement 15 (FASB 15) in accounting for the restructuring of debts of troubled borrowers. The reporting for such restructured debt was also changed so that it was no longer included in the schedule of non-performing loans.

The thrust of all these initiatives is to minimize as much as possible any short term financial and/or regulatory factors which may have reduced a bank's willingness or ability to work with their troubled borrowers. In essence, banks should be able to base lending decisions on what is in the long-term best interest of the bank, the borrower and the community. For example various federal and state support programs for farmers have been proposed which would grant them some form of assistance if the existing lender makes certain concessions. Banks are now free to decide whether to participate in these programs without fear of uncertain regulatory reaction.

7. What is the FDIC doing to monitor and evaluate the extent to which the benefits expected to result for the banks' loan customers and communities are in fact being delivered by this program?

We have sent a letter dated March 27, 1986 which explains capital forbearance to the Chief Executive Officer of each insured state nonmember bank. A second letter to the same group dated April 11, 1986 provided a detailed explanation of FASB 15. Memorandums were forwarded to each FDIC Regional Director explaining operating procedures for implementing the capital forbearance program. In addition the program has been thoroughly discussed in meetings of Regional Directors and senior management of the Washington Office. There have also been appearances at bankers' meetings. We have participated in 17 seminars or presentations in bankers' meetings in six agricultural and/or energy states. In addition video and audio tapes of some of these meetings have been made available to bankers through private organizations.

We have made every effort to communicate our policies to the banking community. In order to measure the program's actual implementation we initiated an ongoing reporting system beginning May 31, 1986 and we have provided this data in answers to other questions. It should be kept in mind, however, that the responsibility rests with the banks to apply for capital forbearance. While the number of applications to date has not been significant, the program is still new and it is believed too soon to form any judgments regarding its effectiveness.

Sincerely,

L. William Seidman
Chairman

Mr. BARNARD. Mr. Downey, we're glad to have you with us this morning. We will hear from you at this time.

STATEMENT OF JOHN F. DOWNEY, CHIEF NATIONAL BANK EXAMINER, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. DOWNEY. Mr. Chairman and members of the subcommittee, I welcome this opportunity to appear before you today to discuss the Comptroller's capital forbearance policies. I will present only the highlights of my written statement with the understanding that my entire testimony will be entered into the record. In addition, I will attempt to refrain from repeating material already presented by Mr. Meadows.

The Comptroller's Office and the FDIC generally agree on the nature of the problems confronting agricultural and oil and gas banks. We also generally agree on the appropriate role of the supervisory agencies. The most beneficial thing we can do for these banks is to ensure that they have the time, the opportunities, and the incentives to work with their borrowers to achieve mutually satisfactory repayment programs.

As you know, the past few years have proven to be a very difficult period for agricultural and oil and gas banks. About 870 of the almost 5,000 national banks are considered agricultural or oil and gas banks. These banks have 25 percent or more of their portfolios in loans to agricultural or oil and gas borrowers. Of the 870 banks, 241 suffered losses in 1985. That's up from 195 in 1984 and 139 in 1983. About one-sixth, or approximately 145 banks, were considered problem banks. However, due to the historically high levels of capital these banks maintained, only 15 of the national agricultural and oil and gas banks had primary capital below 5.5 percent of assets at year end 1985. Five and one-half percent is the threshold ratio established by the Comptroller through regulation as the minimum level for well-managed banks.

Despite the difficult problems facing many agricultural and oil and gas banks, we believe that most have sound prospects for the future. These banks retain substantial strength. Over 92 percent of the national agricultural and oil and gas banks had primary capital as of year-end 1985 in excess of 7 percent. Over 38 percent of them had primary capital above 10 percent.

For those agricultural and oil and gas banks that are suffering, the three bank regulatory agencies issued capital forbearance policies at the end of March. 1986. The Comptroller's policies are substantially the same as the FDIC's, with one addition. We amended the rules that limit the size of loans relative to capital that banks can make to a single borrower. For banks suffering reduced capital as a result of agricultural and oil and gas loan losses, we increased the general lending limit from 15 percent of capital to a maximum of 20 percent of capital. This change allowed those banks the benefit of continuing their relationship with sound, performing borrowers.

We sent out our capital forbearance policies to all national banks and to agricultural trade groups. Our district and headquarters officials have met with numerous groups of bankers and farm organizations. We have met in Washington, DC, and locations around the

country convenient to those most interested in our policies. We have been quite active in explaining the program and encouraging banks to let us know whenever our forbearance is appropriate. As Comptroller of the Currency Robert Clarke has advised our district officials, we will "look for opportunities to grant forbearance, not deny it."

The capital forbearance policy enables banks to recognize loan losses and restructure problem loans. It allows them to operate temporarily with lower levels of capital than otherwise would be appropriate. Bankers' recognition of the regulators' willingness to grant forbearance, rather than a perception that regulators always take enforcement action against declining capital levels, is expected to improve the opportunities for borrowers to seek and receive restructured loan terms.

In addition, the Office's increase in the lending limit helps banks continue lending to their local communities despite the fact that they have experienced abnormal loan losses. As a result of the increased lending limits, banks will be able to continue to meet the financial needs of their communities throughout the downturns in the agricultural and oil and gas sectors.

When bankers anticipate regulatory enforcement action, they feel pressured to look for short-term solutions to problem loans. Short-term solutions can often be drastic, but when bankers are aware that their regulators are going to look at long-term solutions to bankers' problems, bankers have more opportunities to look at long-term solutions to their borrowers' problems. We believe that our capital forbearance policies—our enforcement posture, support for GAAP accounting, reporting changes, and lending limit changes—all remove impediments that bankers faced in dealing with their troubled borrowers.

The success of the capital forbearance policies in meeting their objectives are, of course, dependent on actions bankers undertake. Our capital forbearance policies were introduced on March 28, 1986, and, therefore, have been in effect less than 3 months.

Again, we have about 870 banks that meet the definition of agricultural or oil and gas banks.

As of early June, we had received 14 requests that we grant capital forbearance. It is interesting to note that each of the 14 banks already was subject to a formal, enforceable, regulatory action at the time that it made its initial request. That is, these banks may have had problems other than inadequate capital.

Notwithstanding, we have approved four requests and denied only one. One bank failed, and one bank has withdrawn its request. The remaining requests are pending. Some of the initial communications did not provide us with sufficient information to make a decision, and, where appropriate, we have asked for additional information. Two requests were received just as of last week. More information on those 14 requests is contained in my written statement.

Our meetings with various bankers in the Midwest and Southwest and with the ABA/IBAA Agricultural Task Force lead us to believe that there are many bankers who were hesitant to make the judgment call that certain loans should be written off, solely because they feared that the regulators would respond with a re-

quest for additional capital. These banks may have capital ratios at or above 9 percent and were anticipating writing off enough loans to drop their capital ratios down to, let's say, 6 percent. They were concerned that such a capital decline would prompt the regulatory agencies to demand that capital be restored toward historical levels within a matter of a few months.

The capital forbearance policy makes clear that well-managed agricultural and oil and gas banks in that situation have nothing to fear. Banking Circular 212, which articulates the new policies, states that we will not take an enforcement action solely on the basis of such a decline in capital. Bankers are encouraged to recognize their losses, work with their borrowers, and make long-term plans to ensure adequate capital. The OCC's capital forbearance policies support these efforts.

Mr. Chairman, you asked us specifically to advise the subcommittee of our efforts to monitor the capital forbearance policies. This monitoring is taking many forms. For example, the Office is monitoring action on specific requests for capital forbearance at the district office level. Potential applicants require time to verify their eligibility, to develop plans for restoring capital, and to submit applications. We are just beginning to see these applications flow into our district offices.

We are monitoring banks whose capital declines through our normal examination and supervisory processes. Our Washington, DC, headquarters also monitors district treatment of such banks during our periodic quality control reviews of their compliance with nationwide policies. In addition, we will be able to monitor the impact of the lending limit changes through an analysis of information to be submitted by the banks in their call reports.

Last but not least, we expect to receive feedback from the banking industry and farmer organizations on the effectiveness of our policies. These groups were instrumental in bringing the extent of the problems and a variety of the possible actions to our attention before we issued Banking Circular 212, and we are certain that we will hear from them if additional actions are desired.

In conclusion, we believe that our recent regulatory policies help provide agricultural and oil and gas banks with incentives and time to address asset quality problems in an orderly manner. This will enable them to meet the needs of the borrowers they serve and to help rehabilitate both the borrowers and themselves.

Mr. Chairman, that concludes my oral presentation. I would be happy to answer any questions.

[The prepared statement of Mr. Downey, and Banking Circulars 212 and 195 follow:]

STATEMENT OF

JOHN F. DOWNEY

CHIEF NATIONAL BANK EXAMINER

Before the

COMMERCE, CONSUMER, AND MONETARY AFFAIRS SUBCOMMITTEE

of the

COMMITTEE ON GOVERNMENT OPERATIONS

U.S. HOUSE OF REPRESENTATIVES

June 17, 1986

Mr. Chairman and members of the Subcommittee, I welcome this opportunity to appear before you to discuss the Office's capital forbearance policy for banks experiencing serious problems because of loans to the agricultural and oil and gas sectors.

Troubled Agricultural and Oil and Gas Sectors

As you know, the past few years have proven to be a particularly difficult period for banks that lend primarily to the agricul al and oil and gas industries. About 870 of the almost 5,000 natio l banks are considered agricultural and/or oil and gas banks. Of these 870 banks, 241 suffered losses in 1985, up from 195 in 1984 and 139 in 1983. About one-sixth, 146 banks, were considered problem banks. However, due to the historically high levels of

capital these banks maintained, only 15 of the national agricultural/oil and gas banks had primary capital ratios, as of year-end 1985, below the 5-1/2 percent threshhold established by the OCC through regulation as the minimum level for well-managed banks.

Severe financial pressures on borrowers dependent on the agricultural and oil and gas sectors have resulted in an increase in loan delinquencies. As conditions worsen, borrowers increasingly fear foreclosure, while bankers become increasingly concerned about supervisory actions that may result from a reduction in their bank's capital as a consequence of loan losses. And, as we have seen, creditor foreclosures in troubled sectors often result in abnormally high losses due to the depressed prices the collateral will bring in the marketplace.

The persistent downturn in the agricultural and energy sectors of the economy during the 1980's has placed pressure on capital at many agricultural and energy banks. Many of these banks fear that additional loan charge-offs could cause regulators to require them to raise more capital. As a result, some banks have been reluctant to restructure loans or grant other concessions to borrowers that could trigger regulatory responses. Agricultural and oil and gas banks tend to have less diversified asset portfolios and a greater dependence on their local economies than other banks. These banks are aware that any decline in capital would be of particular concern

to regulators. In addition, banks have been reluctant to reduce capital because it is the basis for determining the amount that a bank can lend to any one borrower. Lower capital levels result in lower lending limits for all borrowers at the bank, including sound, profitable borrowers.

Despite the difficult problems facing many agricultural and oil and gas banks, we believe that most have sound prospects for the future. Even with the losses suffered by these banks and the likelihood that losses will continue to occur, these banks retain substantial strength. Over 92 percent of the national agricultural and oil and gas banks had primary capital ratios, as of year-end 1985, above 7%; over 38 percent of them had primary capital ratios above 10 percent. It continues to be our view that the most beneficial thing that we can do for agricultural and oil and gas banks and their borrowers during this difficult but transitional period is to ensure that they have the opportunity and incentive to work together to achieve mutually satisfactory loan workout plans.

Accordingly, this Office, in conjunction with the Federal Deposit Insurance Corporation and the Federal Reserve Board, instituted supervisory policies that would give banks the tools and the encouragement to restructure problem loans. On March 28, 1986, the Comptroller issued a five-point program contained in Banking Circular 212:

- First, we again encouraged banks to enter into work-out plans with their borrowers who are experiencing temporary difficulties;

- Second, we repeated our prior encouragement to banks that they familiarize themselves with the opportunities afforded by Financial Accounting Standards (FAS) No. 15. Under FAS 15, a bank need not recognize any loss on a restructured loan when the expected payments, principal and interest combined, equal or exceed the loan amount on the bank's books prior to the restructuring;

- Third, we modified the reporting requirements for restructured loans so that restructured loans being paid in accordance with the modified terms are no longer categorized as problem loans. Previously, all restructured loans were reported with problem loans;

- Fourth, we instituted a capital forbearance policy that allows well-managed banks whose capital falls significantly below prescribed levels, as a result of problems in the agricultural and oil and gas sectors, up to 7 years to restore capital; and

- Fifth, we amended the rules that limit the size of loans relative to capital that banks can make to a single borrower. For banks suffering reduced capital as a result of agricultural and oil and gas loan losses, we increased the general lending limit from 15% of capital to a maximum of 20% of capital.

The Office sent Banking Circular 212 to all national banks and to agricultural trade groups. Our District and headquarters officials have met with numerous groups of bankers and farmer organizations, not only in Washington, DC, but also in locations around the country convenient to those most interested in our policies. We have been quite active in explaining the program and encouraging banks to let us know whenever our forbearance is appropriate. As Comptroller of the Currency Robert Clarke has advised our District officials, we will "look for opportunities to grant forbearance, not deny it."

Effect of Policies on Loan Customers and Communities

The Office's five-point program is expected to provide national agricultural and oil and gas banks with the incentives and the time to meet the needs of the borrowers and communities that they serve. The program encourages banks to enter into work-out plans with their

agricultural and energy borrowers who are experiencing temporary difficulties. Such encouragement should increase the likelihood that loan restructurings are arranged, reduce borrowers' debt service requirements, and keep foreclosures to a minimum.

Banks are encouraged to make use of FAS 15, which was adopted by the accounting profession in 1977, to account for restructured debt. FAS 15 can, under certain circumstances, be used to account for concessions in financing terms (i.e., reduction of either principal or interest) granted to borrowers experiencing financial difficulty without requiring the lender to record any losses. FAS 15 applies to restructurings of loans in any industry, not just agricultural or oil and gas loans. In order to promote loan restructurings, revisions are being made to the Call Report treatment of restructured debt so that restructured loans being paid in accordance with their new terms are reported independently of problem loans. It is expected that encouraged use of generally accepted accounting principles, such as FAS 15, and new reporting requirements for restructured loans, will increase the likelihood that banks will be more willing to restructure problem agricultural and oil and gas loans.

Probably the most significant aspect of the Office's five-point program to assist troubled agricultural and oil and gas banks is the capital forbearance policy. The minimum primary capital ratio established by regulation is 5-1/2 percent of total assets for well-managed banks. The banking agencies require each bank to maintain capital, above the 5-1/2 percent threshhold, adequate for its particular circumstances, including, as in the case of troubled agricultural and oil and gas banks, its level of weakened assets and its limited diversification of risks.

Bank regulators monitor capital levels to assess the strength of an individual bank. Under the capital forbearance policy, the OCC will not take action to enforce minimum capital requirements on a bank whose primary capital ratio declines below the threshhold level of 5-1/2 percent, to no less than 4 percent before December 31, 1987, provided the bank meets the following qualifications and conditions:

- o The bank must have agricultural and oil and gas loans that, in the aggregate, are equal to or greater than 25 percent of the bank's total loans and leases, net of unearned income;

- The weakened capital position of the bank must be largely the result of problems in the agricultural and/or oil and gas sectors of the economy;

- The bank must be well-managed;

- The bank must submit an acceptable plan for restoring capital to the minimums required by January 1, 1993; and

- The bank must commit to file annual progress reports regarding compliance with its capital plan.

Furthermore, on a case-by-case basis, this Office will consider applications for capital forbearance from banks with primary capital ratios lower than 4 percent and from banks that do not meet the definition of an agricultural/oil and gas bank but nevertheless are suffering capital declines due to problems in the agricultural and oil and gas sectors.

The Office's capital forbearance also extends to well-managed agricultural and oil and gas banks whose capital falls well below historical levels as a result of losses from those sectors of the economy, yet remains above regulatory minimums. These banks will not be subjected to regulatory actions solely on the basis of that decline in capital, as some believed they might have been in the past. We expect that the number of banks fitting this

description far exceeds the number whose capital falls below regulatory minimums. As of year-end 1985, only 15 national agricultural and oil and gas banks had a primary capital ratio below the regulatory minimum of 5-1/2 percent, but 241 of the approximately 870 national agricultural/oil and gas banks suffered losses that year.

The capital forbearance policy enables banks to recognize loan losses and restructure problem loans with the ability to operate temporarily with lower levels of capital than otherwise would be appropriate. Capital forbearance is a significant regulatory policy intended to assist troubled oil and gas and agricultural banks through a difficult economic period. Bankers' recognition of regulators' willingness to grant forbearance, rather than a perception that regulators always take enforcement action against declining capital levels, is expected to improve the opportunities for borrowers to seek and receive restructured loan terms.

Furthermore, it is our hope that the capital forbearance plan will encourage banks to take advantage of the Farmers Home Administration's (FmHA) guarantee programs. Under such programs, FmHA typically guarantees a percentage of a renegotiated loan on which the bank has made interest and/or principal concessions sufficient to enable the borrower to service the restructured debt. Because of our capital forbearance policy, loan write-downs could qualify loans for such FmHA programs, but would not trigger a

regulatory requirement for prompt capital restoration. Therefore, to the extent that the capital forbearance policy increases participation in FmHA guarantee programs, borrowers will have increased opportunities to work their way out of current problems.

In addition, the Office's increase in the lending limit helps banks continue lending to their local communities despite the fact that loan losses remain high. As a result of the increased lending limit, banks will be able to continue to meet the financial needs of their communities throughout the downturns in agriculture and oil and gas.

When bankers anticipate regulatory enforcement action, they feel pressure to look for short-term solutions to problem loans. Short-term solutions can often be drastic. But, when bankers are aware that their regulators are going to look at long-term solutions to bankers' problems, bankers have more opportunities to look at long-term solutions to their borrowers' problems. We believe that our capital forbearance policies -- our enforcement posture, support for GAAP accounting, reporting changes, and lending limit changes -- all remove impediments that bankers faced in dealing with their troubled borrowers.

Requests for Capital Forbearance

The success of the capital forbearance policies in meeting their objectives are, of course, dependent on actions bankers undertake. Our capital forbearance policies were introduced on March 28, 1986, and therefore, have been in effect about two months.

Our records show that as of year-end 1985, about 870 national banks met the definition of agricultural/oil and gas banks as defined for purposes of our capital forbearance policies (i.e., had aggregate agricultural and oil and gas loans equal to or greater than 25 percent of the bank's total loans and leases, net of unearned income). Almost half, 405, are in our seven-state Midwestern District; 207 are in the Southwestern District; 166 are in the Central District; 81 are in the Western District; 4 are in the Southeastern District; and 3 are in the Northeastern District. (Appendix A lists the states within each District.)

As of early June, we had received 14 requests that we grant capital forbearance. Each of the 14 banks was subject to a formal, enforceable regulatory action at the time that it made its initial written request. Some of the initial communications did not provide sufficient information for the OCC to

make a decision, and where appropriate we have sought additional information. A description of the current status of the 14 cases is set forth below.

Capital Forbearance Requests

District	Primary Capital Ratio	Status as Ag/Oil & Gas Bank	Status
Southwestern	4.25%	Not determined	Pending
Southwestern	6.58%	Not determined	Pending
Southwestern	6.05%	No	Denied
Southwestern	5.82%	Agricultural	Approved
Southwestern	6.57%	Agricultural	Approved
Southwestern	Negative	Not determined	Bank failed
Central	5.49%	Agricultural	Pending
Central	7.85%	Agricultural	Pending
Central	4.50%	No	Withdrawn
Midwestern	5.42%	Agricultural	Pending
Midwestern	7.60%	Agricultural	Pending
Midwestern	6.30%	No	Pending
Midwestern	3.71%	Agricultural	Approved
Midwestern	6.25%	Agricultural	Approved

The one bank that was denied some form of capital forbearance was neither an agricultural nor an oil and gas bank. Its problems were not attributable to problems within the agricultural or oil and gas sectors. The bank had not been well managed, it had longstanding, chronic capital problems, and its management and board of directors had not paid adequate attention to the bank's capital adequacy. The bank is presently subject to a cease and desist order.

Our meetings with various bankers, in the Midwest and Southwest, and with the ABA/IBAA Agricultural Task Force, lead us to believe that there are many bankers who were hesitant to make the judgment call that certain loans should be written off, solely because they feared that their regulators would respond with a request for additional capital. These banks may have capital ratios at or above 9 percent and were anticipating writing off enough loans to drop their capital ratios down to perhaps 6 percent. They were concerned that such a capital decline would prompt the regulatory agencies to demand that capital be restored toward historical levels within a matter of a few months.

The capital forbearance policy makes clear that well-managed agricultural/oil and gas banks in that situation have nothing to fear. Banking Circular 212 states that we will not take an enforcement action solely on the basis of such a decline in capital. Bankers are encouraged to recognize their losses, work with their borrowers, and make long-term plans to ensure adequate capital. This Office's captial forbearance policies support those efforts.

Monitoring Capital Forbearance Policy Implementation

You asked us specifically to advise the Committee of our efforts to monitor the capital forbearance policies. This monitoring takes many forms. For example, the Office is monitoring action on specific requests for capital forbearance at the District office level. Potential applicants require time to verify their eligibility, to develop plans for restoring capital by January 1, 1993, and to submit applications.

We are monitoring banks whose capital declines through our normal examination and supervisory processes. Our Washington, DC headquarters also monitors District treatment of such banks during our periodic quality control reviews of their compliance with nationwide policies. In addition, we will be able to monitor the impact of the lending limit changes through an analysis of information to be submitted by banks in the revised call reports, after their June 30, 1986, implementation.

Last but not least, we expect to receive feedback from the banking industry and farmer organizations on the effectiveness of our policies. These groups were instrumental in bringing the extent of problems and a variety of possible actions to our attention before we issued Banking Circular 212, and we are certain that we will hear from them if additional actions are desired.

Conclusion

We believe that the regulatory policies contained in our five-point program will provide agricultural and oil and gas banks with the incentives and the time needed to address asset quality problems in an orderly manner, to meet the needs of the borrowers they serve, and to help rehabilitate both the borrowers and the bank. It is only by identifying their losses and restructuring credits that these banks will be able to improve the quality of their portfolios, and regulators' capital forbearance policies are a key ingredient in enabling banks to do so.

APPENDIX A

STATES IN OCC DISTRICTS

Northeastern District	Southeastern District	Central District
Connecticut	Alabama	Kentucky
Delaware	Florida	Illinois
District of Columbia	Georgia	Indiana
Maine	Mississippi	Michigan
Maryland	North Carolina	Ohio
Massachusetts	South Carolina	Wisconsin
New Hampshire	Tennessee	
New Jersey	Virginia	
New York	West Virginia	
Pennsylvania		
Puerto Rico		
Rhode Island		
Vermont		
Virgin Islands		

Midwestern District	Southwestern District	Western District
Iowa	Arkansas	Alaska
Kansas	Louisiana	Arizona
Minnesota	New Mexico	California
Missouri	Oklahoma	Colorado
Nebraska	Texas	Guam
North Dakota		Hawaii
South Dakota		Idaho
		Montana
		Nevada
		Oregon
		Utah
		Washington
		Wyoming

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BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: Capital Forbearance Policies

To: Chief Executive Officers of all National Banks, Deputy Comptrollers, Department and Division Heads, and Examining Personnel

Subject: Capital Forbearance Policies

Contents:

I. Introduction
II. Bank Relationships with Troubled Borrowers
III. Capital Forbearance Policy
IV. Accounting for Troubled Debt Restructurings
V. Call Report Changes
VI. Lending Limits

I. INTRODUCTION

The last few years have proved to be a particularly difficult period for farm and oil and gas banks and their borrowers. Many farmers and others dependent on the agricultural economy have experienced, and continue to experience, financial difficulties. During this period, an historicaliy large number of farm banks have failed and an even larger number have developed serious problems. Similarly, volatile energy prices have adversely impacted oil and gas borrowers and the banks that lend heavily to them.

In light of these problems, the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation believe it appropriate to employ supervisory policies that will support basically sound, well-managed banks in weathering what is expected to be a difficult but transitional period. In connection with their recent testimony before Congress, the agencies released a Joint Policy Statement on March 11, 1986, outlining these policies. Although the statement refers only to agricultural banks, it has been extended to oil and gas banks by subsequent agreement among the agencies. A copy of the Joint Policy Statement is attached.

This Circular explains how the Office of the Comptroller of the Currency will implement the Joint Policy Statement. Implementation will be accomplished by encouraging banks to

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work with their troubled agricultural and oil and gas borrowers; by establishing a capital forbearance policy; by encouraging the use of generally accepted accounting principles which may permit loan restructurings without loss recognition; by changes to Call Reports; and by relaxing lending limits.

The Congress is considering legislation covering capital forbearance, Call Reports, and lending limits, among other matters. Modification of this Circular may be required if legislation is enacted.

Certain provisions contained in this Circular are subject to approval by the Office of Management and Budget, where they are currently under review.

II. BANK RELATIONSHIPS WITH TROUBLED BORROWERS

Problems in the agricultural economy have directly affected the banks that provide financing for the agricultural sector. Severe financial pressures on borrowers dependent on the agricultural economy have resulted in an increase in loan delinquencies. As conditions have worsened, borrowers increasingly fear foreclosure, while bankers are increasingly concerned about supervisory actions that may result from reduction in their banks' capital as a consequence of loan losses.

In response to this situation, the OCC has encouraged bankers to develop work-out strategies with their agricultural borrowers. In a joint statement on April 23, 1985, the Federal bank regulatory agencies reiterated their policy of encouraging banks to enter into work-out plans with agricultural borrowers who are experiencing temporary difficulties in meeting their debt service obligations. The OCC renews that encouragement now.

Although OCC examiners will point out to management the weaknesses that may be present in loans, the OCC does not require foreclosure on collateral or the acceleration of the maturity of loans. The OCC recognizes that downturns in certain sectors of the economy are expected to be transitory. Therefore, lenders may find that the most prudent policy is to restructure the loan terms rather than to take more precipitous action such as foreclosure.

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The volatility in energy prices has created a similar situation between oil and gas companies and the banks that lend to them. Accordingly, the OCC also encourages banks to develop appropriate work-out strategies with their oil and gas borrowers.

III. CAPITAL FORBEARANCE POLICY

Despite the difficult problems facing many agricultural and oil and gas banks, the OCC believes that most have sound prospects for the future. Even with the losses suffered by these banks and the likelihood that losses will continue to occur, these banks retain substantial strength. Many of them possess strong capital to asset ratios and capable management that adheres to sound lending policies.

Accordingly, the OCC has adopted, effective immediately, a capital forbearance policy which will benefit basically well-managed banks that have sufficient capital to absorb loan losses and reasonable prospects to replenish capital. Capital forbearance formally acknowledges that capital should be used during periods of unusually heavy loan losses and that capital replenishment takes time. The capital forbearance policy should provide banks greater incentives to recognize promptly losses arising in their loan portfolios, work with borrowers to restructure loans, and rebuild bank capital in an orderly manner. This capital forbearance policy is temporary and will terminate on January 1, 1993.

Under the capital forbearance policy, the OCC will not take administrative action to enforce the minimum capital requirements in 12 CFR Part 3 against a bank whose primary capital ratio declines below 5-1/2 percent to no less than 4 percent before December 31, 1987, provided the bank meets the following qualifications and conditions:

1. The bank must meet the definition of an agricultural/oil and gas bank. An agricultural/oil and gas bank is one whose agricultural and oil and gas loans, in the aggregate, are equal to or greater than 25 percent of the bank's total loans and leases, net of unearned income. Agricultural loans are defined as loans secured by farmland and loans to

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finance agricultural production and other loans to farmers from Schedule C on the bank's Call Report. A list of the kinds of loans qualifying as oil and gas loans for purposes of the capital forbearance policy is attached as Exhibit A.

2. The weakened capital position of the bank must be largely the result of problems in the agricultural and/or oil and gas sectors of the economy and not due to excessive bank operating expenses, insider abuse, excessive dividends or actions taken solely for the purpose of qualifying for capital forbearance.

3. The bank must be well-managed. In reaching determinations about the quality of a bank's management, the OCC will take into account existing management's past record of performance in guiding the bank, including its timely recognition of loan losses and other weaknesses. The OCC will also consider the bank's past compliance with any agreements with, commitments to, or orders from the OCC. Further, the OCC will consider the capability of management to develop and implement an acceptable rehabilitative plan.

4. The bank must submit an acceptable plan for restoring capital by January 1, 1993 to the minimums required by 12 CFR Part 3. The plan should describe the means and schedule by which capital will be increased. This plan should also specifically address reduced dividend levels; limitations on the compensation of directors, executive officers or individuals having a controlling interest; limits on asset growth; and payments for services or products furnished by affiliated companies.* The plan should provide for improvement in the bank's primary

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* Banks should also refer to Banking Circular No. 115, "Income Diversion Through Management and Other Fees", dated August 30, 1978, and Supplement No. 1 thereto, dated December 28, 1978.

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capital ratio on a continuous or periodic basis from earnings, capital injections, asset shrinkage, or a combination thereof. A plan which projects no significant improvement in capital until near the end of the forbearance period will not normally be acceptable. The OCC may require modifications to a bank's plan in order for the bank to receive, or to continue to receive, capital forbearance.

5. The bank must commit to file annual progress reports regarding compliance with its capital plan. Depending on an individual bank's progress, more frequent reports may be required. Moreover, any contemplated actions that would represent a material variance from the capital plan must be submitted to the OCC for review.

Banks with capital below the minimums established in 12 CFR Part 3 seeking capital forbearance must file a written request no later than December 31, 1987 with the Deputy Comptroller for the District in which the bank is located. The request must include a certification and explanation of its eligibility to participate (covering items 1 through 3 above), its plan, and its commitment to file the required reports. Capital forbearance will be considered granted unless, within 60 days of receipt of the request, the District notifies the bank that its request has been denied or that additional information or time is required. Pursuant to 12 CFR 3.8, during the period covered by this capital forbearance policy, a bank granted capital forbearance and in compliance with an acceptable capital plan will not be considered in violation of the minimum capital ratios required by 12 CFR 3.6.

Upon the written request of an agricultural/oil and gas bank and at the discretion of the OCC, the capital forbearance policy may be extended, in special circumstances, to a bank with a primary capital ratio lower than 4 percent. In addition, the OCC will consider extending its capital forbearance policy to banks which do not meet the above definition of an agricultural/oil and gas bank, but nevertheless are suffering capital declines caused by problems in the agricultural or oil and gas sectors. Capital forbearance may be extended to these banks only on a

case-by-case basis upon written request and explanation submitted to the District Deputy Comptroller. In both circumstances, capital forbearance will not be considered granted until the District so notifies the bank.

The OCC reserves the right to terminate capital forbearance for banks engaged in unsafe or unsound or other objectionable practices, or if it becomes apparent to the OCC that the bank is unwilling or unable to comply with an acceptable capital plan. Capital forbearance, once granted, will not be terminated solely on the basis of subsequent changes in a bank's percentage of loans to agricultural and/or oil and gas borrowers.

Some banks are at present subject to capital requirements higher than those specified in 12 CFR 3 by a capital directive, an effective order issued pursuant to 12 USC 1818, or a formal agreement between a bank and the OCC. Banks which have experienced agricultural or oil and gas losses and which are subject to a capital ratio higher than the minimums set forth in 12 CFR 3.6 may request a modification from the OCC. The OCC will reconsider the higher requirement in light of the capital forbearance policy.

In addition, the OCC capital forbearance policy extends to well-managed banks whose primary capital ratios decline, as a result of problems in the agricultural or oil and gas sectors of the economy, from historic levels to levels above the 5-1/2 percent minimum primary capital ratio. These banks do not have to apply for capital forbearance, and the OCC will not require them to take any action solely on the basis of that decline in capital. These banks will be expected to maintain adequate capital for the nature of their operations and, if appropriate, to increase their capital over time back to historic levels. In addition, these banks must recognize that asset growth should be accompanied by appropriate increases in capital.

All banks which are operating with capital levels below those which would be expected under normal economic conditions should be aware that the OCC will be unlikely to approve applications by them to acquire other banks. Similarly, the OCC will be likely to object to changes in control or acquisitions of such banks unless the transaction will result in prompt restoration of capital to appropriate levels.

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The implementation of the OCC's capital forbearance policy has no effect on balance sheet or income statement items reported in Call Reports or other financial statements, nor does it allow banks to report, as assets, loans (or portions thereof) considered losses. On the contrary, the policy retains existing financial presentation rules and creates no inconsistencies with generally accepted accounting principles. The OCC believes that maintaining the integrity of financial statements is vital to assuring confidence in the banking system.

IV. ACCOUNTING FOR TROUBLED DEBT RESTRUCTURINGS

The OCC has followed, and will continue to follow generally accepted accounting principles with respect to loans which have been formally restructured to enable the borrower to service the debt. Statement of Financial Accounting Standards No. 15 (FAS 15), Accounting by Debtors and Creditors for Troubled Debt Restructurings, governs the accounting for such restructurings. This Standard allows a loan to continue to be carried on the bank's books without any loss recognition if the loan is formally restructured in a manner so that it is probable and estimable that the borrower can repay the loan under the new terms, and that the total future cash payments by the borrower (principal and interest combined) at least equals the loan amount on the bank's books.

Accordingly, a bank which reasonably expects a borrower's future cash payments to equal or exceed the loan amount does not need to recognize a loss on the restructuring. In those situations where it is expected that the future cash payments on the restructured loan will be less than the loan amount, the loss recognized is limited to the expected cash flow deficiency.

Attached is a copy of Banking Circular 195, which includes more specific details of the accounting provisions. Bankers are encouraged to familiarize themselves with the accounting treatment described in FAS 15.

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V. CALL REPORT CHANGES

Two changes are being made to the Call Reports, expected to be effective with the reports for the quarter ending June 30, 1986. One is needed to monitor the capital forbearance policy and potential changes to legal lending limits for national banks; the other is designed to prevent misconceptions about certain restructured loans.

Schedule RI-B, "Charge-offs and Recoveries and Changes in Allowance and Lease Losses," will be changed for national banks to provide information relative to capital forbearance and legal lending limits. Memorandum items will be added to this schedule to identify a bank's charge-offs and recoveries of Special Category Loans on a cumulative basis since January 1, 1986. Special Category Loans are defined as (a) loans secured by farmland and loans to finance agricultural production and other loans to farmers from Schedule C of the bank's Call Report and (b) the oil and gas loans listed on Exhibit A hereto. Should the definitions change, the OCC will provide national banks with revised definitions prior to the due date for the Call Report first affected by the change.

The second set of changes involves the reporting of renegotiated "troubled" debt. The existing Schedule RC-N ("Past Due, Nonaccrual, and Renegotiated Loans and Lease Financing Receivables"), will be modified by removing the column entitled "Renegotiated troubled debt." Renegotiated loans which are performing in compliance with the modified terms will be reported in the memorandum section of Schedule RC-C under a new heading "Loans Restructured and In Compliance with Modified Terms." Renegotiated loans that become past due or are otherwise placed in nonaccrual status will be reported in Schedule RC-N in the appropriate categories.

In addition, a new memorandum item will be added to Schedule RC-N to require reporting of total renegotiated "troubled" debt included in the categories 30-89 days past due and accruing, 90 days or more past due and accruing, and nonaccrual. This memorandum item will be maintained for supervisory purposes on a confidential basis.

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VI. LENDING LIMITS

The recognition by a bank of losses on loans reduces not only its capital, but also reduces the maximum amount the bank can lend by law to any single borrower. Lending limits are an important ingredient in protecting the safety and soundness of banks by requiring diversification of credit risks. Many banks have established internal controls limiting the size of loans to any single borrower to an amount less than the legal lending limit. In those banks that do make loans at the legal lending limit, such loans are generally small in number. However, the declines in capital attributable to the problems in the oil and gas and agricultural sectors of the economy may cause some banks to be unable to serve the normal credit needs of a greater number of their creditworthy customers. In order to reduce the impact of these loan losses on a bank's ability to meet the legitimate credit needs of its financially sound customers, the OCC believes it necessary and appropriate to relax lending limits during the period in which the capital forbearance policy is in effect.

The Federal statute governing national bank lending limits is 12 USC 84. The OCC has issued implementing regulations at 12 CFR Part 32. In general, national banks are subject to a general limitation of 15 percent of total capital (i.e. unimpaired capital and unimpaired surplus), and may lend an additional 10 percent of total capital to the same borrower fully secured by readily marketable collateral. There are also a number of exceptions for specified types of loans. Under the statute, the OCC has the authority to establish limits other than those specified.

Under that authority, the OCC contemplates adopting as soon as possible a temporary amendment to 12 CFR Part 32 to be consistent with the purposes of the capital forbearance policy. It is anticipated at present that the amendment would substitute an increased general lending limit for national banks to offset the decline in capital resulting from losses attributable to problems in the agricultural and oil and gas sectors of the economy. As an offset, the new general lending limit would not increase any bank's lending limit above what it would have been had it not experienced losses attributable to

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these troubled economic sectors. The OCC also contemplates including in the amendment a maximum general lending limit of 20 percent to preserve the benefits of risk diversification. The change would cover losses occurring after January 1, 1986 and no later than December 31, 1987, but the effect of those losses on lending limits would continue until January 1, 1993.

The change would allow banks, whose capital declines by no more than 25 percent as a result of losses attributable to agricultural and oil and gas loans, a general lending limit of 15 percent of their capital as of December 31, 1985. For example, a bank with a 10 percent capital ratio, whose capital ratio at December 31, 1985 subsequently declines to 8 percent as a result of losses attributable to the agricultural or oil and gas sectors, would have no reduction in its general lending limit. For banks whose capital ratios are even more dramatically reduced, the effect of the new provision would be a general lending limit of as much as 20% of their reduced capital. The new general lending limit rule would expire simultaneously with the capital forbearance policy on January 1, 1993. Comment will be solicited on the temporary amendment.

Exhibit B hereto is a worksheet which would enable national banks to compute their general lending limits under the new rule. The Comptroller will send appropriate material to national banks relating to the formal adoption of the change to 12 CFR Part 32. The new lending limit will not be effective until formal adoption of the rule.

ORIGINATING OFFICE

Questions regarding this Banking Circular may be directed to the Chief National Bank Examiner's Office, (202) 447-1646.

Robert L. Clarke
Comptroller of the Currency

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BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

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EXHIBIT A

DEFINITIONS OF OIL AND GAS LOANS

The types of loans listed below regardless of purpose will be considered oil and gas loans for the purposes of qualifying for capital forbearance. Wherever "company" is referenced, the caption also assumes "individuals". SIC stands for Standard Industry Codes. See following pages for definitions.

A. Loans to the major integrated oil companies;

B. Loans to companies engaged in operating oil and gas field properties (SIC 1311) (production);

C. Loans to companies primarily engaged in contract drilling (SIC 1381);

D. Loans to companies primarily engaged in performing exploration services on a contract basis (SIC 1382);

E. Loans to companies primarily engaged in performing oil and gas field services (SIC 1389);

F. Loans to petroleum refiners (SIC 2911);

G. Loans to manufacturers and lessors of oil field machinery and equipment (SIC 3533, 7394);

H. Loans to companies primarily engaged in pipeline transportation of petroleum (SIC 4612, 4613);

I. Loans to companies primarily engaged in natural gas transmission or distribution (SIC 4922, 4923, 4924);

J. Loans to companies primarily engaged in investing in oil and gas royalties or leases (SIC 6792);

K. Loans to others engaged in oil and gas related activities.

Major Integrated Oil Companies

International Companies

British Petroleum Co.
Chevron Corp.
Exxon Corp.
Gulf Oil Corp.
Mobil Corp.
Royal Dutch/Shell Group
    Royal Dutch Petroleum Co.
    Shell Oil Co.
    Shell Canada Ltd.
    Shell Transport & Trading Co.
Texaco, Inc.

Domestic Companies

Amerada-Hess
Ashland Oil Co.
Atlantic Richfield Co.
Kerr McGee Corp.
Occidental Petroleum Co.
Pennzoil
Phillips Petroleum Co.
Standard Oil Co. of California
Standard Oil Co. (Indiana)
Standard Oil Co. (Ohio)
Sun Company, Inc.
Tenneco Co.
Unocal

SIC CODES

SIC 1311 Crude Petroleum and Natural Gas

Establishments primarily engaged in operating oil and gas field properties. Such activities include exploration for crude petroleum and natural gas; drilling, completing, and equipping wells; operation of separators, emulsion breakers, desilting

equipment; and all other activities in the preparation of oil and gas up to the point of shipment from the producing property. Also includes the production of oil through the mining and extraction of oil from oil shale and oil sands.

SIC 1381 Drilling Oil and Gas Wells

Establishments primarily engaged in drilling wells for oil or gas field operations for others on a contract, fee, or similar basis. Includes contractors that specialize in "spudding in," "drilling in," redrilling, and directional drilling.

SIC 1382 Oil and Gas Field Exploration Services

Establisnments primarily engaged in performing geophysical, geological, and other exploration services for oil and gas on a contract, fee or similar basis.

SIC 1389 Oil and Gas Field Services

Establishment primarily engaged in performing oil and gas field services, for others on a contract, fee, or similar basis, such as excavating slush pits and cellars; grading, and building of foundations at well locations; well surveying; running, cutting, and pulling casings, tubes, and rods; cementing wells; shooting wells; perforating well casing; acidizing and chemically treating wells; and cleaning out, bailing, and swabbing wells.

SIC 2911 Petroleum Refining

Establishments primarily engaged in producing gasoline, kerosene, distillate fuel oils, residual fuel oils, lubricants and other products from crude petroleum and its fractionation products, through straight distillation of crude oil, redistillation of unfinished petroleum derivatives, cracking or other processes.

EXHIBIT A (Continued)

SIC 3533 Oil Field Machinery and Equipment

Establishments primarily engaged in manufacturing machinery and equipment for use in oil and gas fields.

SIC 7394 Equipment Rental and Leasing Services

- Oil field equipment rental
- Oil well drilling equipment rental: machinery, drilling bits, etc.

SIC 4612 Crude Petroleum Pipe Lines

Establishments primarily engaged in the pipe line transportation of crude petroleum

SIC 4613 Refined Petroleum Pipe Lines

Establishments primarily engaged in the pipe line transportation of refined products of petroleum, such as gasoline and fuel oil.

SIC 4922 Natural Gas Transmission

Establishments engaged in the transmission and/or storage of natural gas for sale.

SIC 4923 Natural Gas Transmission and Distribution

Estalishments engaged in both the transmission and distribution of natural gas for sale.

SIC 4924 Natural Gas Distribution

Establishments engaged in the distribution of natural gas for sale.

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SIC 6792 Oil Royalty Traders

Establishments primarily engaged in investing in oil and gas royalties or leases, or fractional interest therein.

SIC 1321 Natural Gas Liquids Production

Establishments primarily engaged in producing liquid hydrocarbons from oil and gas field gases.

SIC 1623 Pipe Line Construction

- Distribution lines (oil and gas field construction)
- Pipe laying
- Pipe line construction
- Pipe line wrapping
- Pumping station construction

SIC 1629 Heavy Construction

- Oil refinery construction
- Petroleum refinery construction

SIC 3494 Valves and Pipe Fittings

SIC 3498 Fabricated Pipe and Fabricated Pipe Fittings

SIC 3559 Special Industry Machinery

- Petroleum refinery equipment

SIC 4226 Special Warehousing and Storage

- Oil and gasoline storage caverns (for hire)
- Petroleum and chemical bulk stations and terminals for hire

EXHIBIT A (Continued)

SIC 4925 Mixed, Manufactured or Liquified Petroleum Gas Production and/or Distribution

Establishments engaged in the manufacture and/or distribution of gas for sale, including mixtures of manufactured with natural gas.

SIC 5084 Industrial Machinery and Equipment

- Derricks (Wholesale)
- Drilling bits (Wholesale)
- Oil Refining machinery, equipment, and supplies (Wholesale)
- Oil well machinery, equipment, and supplies (Wholesale)
- Oil well supply houses (Wholesale)

SIC 5171 Petroleum Bulk Stations and Terminals

Establishments primarily engaged in wholesaling petroleum products, including liquified petroleum gas, from bulk liquid storage facilities.

SIC 5172 Petroleum and Petroleum Products Wholesalers

Establishments primarily engaged in wholesaling petroleum and products. Included are packaged and bottled petroleum products distributors, truck jobbers, and others marketing petroleum and products at wholesale.

SIC 6211 Security Brokers, Dealers, and Flotation Companies

- Oil and gas lease brokers
- Dealers in oil royalties

SIC 8911 Engineering, Architectural, and Surveying Services

- Petroleum Engineering

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Others

Establishments and individuals engaged primarily in oil and gas related activities. Examples of such loans would be mortgages and personal loans to individuals whose sole source of repayment is from the profits of an oil or gas company or employment by an oil or gas company.

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EXHIBIT B

GENERAL LENDING LIMITATION CALCULATIONS
(For use until January 1, 1993)

Calculation date _____

1. Total Capital on December 31, 1985.....$_____

2. 15% of the amount on Line 1.....$_____

3. Total Capital on Calculation date.....$_____

4. 15% of the amount of Line 3.....$_____

IF THE AMOUNT ON LINE 4 EQUALS OR EXCEEDS THE AMOUNT ON LINE 2, STOP HERE. THE BANK'S CURRENT GENERAL LENDING LIMITATION IS THE AMOUNT ON LINE 4.

5. Sum of Special Category Loan Charge-offs since December 31, 1985 (but only through December 31, 1987).....$_____

6. Sum of all recoveries since December 31, 1985 on all loans included in Line 5.....$_____

7. Amount on Line 5 minus amount on Line 6.....$_____

8. Amount on Line 3 plus amount on Line 7.....$_____

9. 15% of the amount of Line 8.....$_____

10. 20% of the amount on Line 3.....$_____

11. Lesser of the amounts on Line 9 and Line 10.....$_____

12. Lesser of the amounts on Line 2 and Line 11.....$_____

THE BANK'S CURRENT GENERAL LENDING LIMITATION IS THE AMOUNT ON LINE 12.

Joint Statement of the Federal Reserve Board, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency on Regulatory Policies Toward Agricultural Lenders

The Federal bank regulatory agencies are fully aware of the problems in the agricultural sector of our economy and the financial strains these problems have created for borrowers and lenders. In light of these conditions, the banking agencies believe it appropriate to employ supervisory policies that will assist basically sound, well-managed banks to weather this transitional period, consistent with the need to maintain an adequate supervisory framework and the credibility of regulatory and public financial statements. Supervisory and regulatory policies to help achieve these objectives are outlined below.

In addition to the regulatory policies contained in this statement, the banking agencies continue to urge the Congress and state legislatures to take steps to help maintain the provision of banking services in small communities. The Garn St Germain Act of 1982 prohibits acquisitions across state lines of troubled banks before they have failed and of failed banks with assets under $500 million. The banking agencies believe that these two constraints should be eased by allowing failing bank acquisitions across state lines and by reducing the size criteria so as to maintain the banking services in farm

communities. An easing of state restrictions on branching could also help maintain banking services in small towns in cases when a separately organized and capitalized bank might not be viable.

In order to help alleviate strains on farm lenders and provide additional time to resolve problems in the agricultural sector, the banking agencies express their support for and commitment to the following supervisory policies and principles:

- A major function of capital is to absorb unanticipated losses and help an organization weather a period of adversity. Heavy losses may reduce a bank's capital below normal levels or below minimum regulatory guidelines. The banking agencies will allow a bank experiencing difficulties to operate below the minimum capital requirement provided the bank has the capacity to restore capital within five years.

- The banking agencies reaffirm their policies not to discourage banks from forbearing on farm loans through appropriate debt restructurings, recognizing that such restructurings may be in the interests of both the bank and the borrower when there is a reasonable prospect that the borrower will eventually be able to repay the loan.

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Consistent with their general view toward forbearance, the banking agencies will continue not to require an automatic charge-off of loans that have been restructured. Generally accepted accounting principles, as set forth in Financial Accounting Standard No. 15 (Accounting by Debtors and Creditors for Troubled Debt Restructurings), allow financial institutions to maintain the value of a restructured credit provided that the total of anticipated future cash receipts under the new modified terms which are both probable and can be reasonably estimated at least equals the principal value of the loan. Thus generally accepted accounting principles do not necessarily require the immediate charge-off of loans or portions of loans that have been restructured in accordance with that rule.

The banking agencies see no compelling reason for interpreting or reporting renegotiated debt with nonperforming loans. In line with this view, the agencies propose to modify regulatory reporting and disclosure requirements for restructured debt so that such debt, if it is performing in accordance with the new terms, would be designated as loans "Restructured and In Compliance With Modified Terms."

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BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Banking Circular

Subject Accounting for Restructured Loans and Sales of Fore closed Property

To: Chief Executive Officers of All National Banks, Deputy Comptrollers, District Administrators, Directors and All Examining Personnel

PURPOSE

This issuance provides a summary of the accounting principles applicable to "troubled" debt restructurings and the sale of other real estate owned property (OREO).

BACKGROUND

The financial difficulties being experienced by many borrowers, particularly within the agricultural community, have necessitated the restructuring of loans to borrowers who are unable to meet current or near term contractual loan agreements. These restructurings may involve extending payment schedules; reducing interest rates, principal amounts or accrued interest; granting of a[illegible]onal credit (often in the form of a crop loan for the current year); or transferring property (land or equipment) to the bank in full or partial satisfaction of the debt. These difficulties may also result in foreclosures with the bank becoming the owner and subsequent seller of property.

Regulatory policy requires that debt restructurings be accounted for in accordance with generally accepted accounting principles. The authoritative accounting literature which governs these transactions is Statement of Financial Accounting Standards No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructurings" ("FAS 15"); Accounting Principles Board Opinion No. 21, "Interest on Receivables and Payables" ("APB 21"), and; Statement of Financial Accounting Standards No. 66, "Accounting for Sales of Real Estate" ("FAS 66").

ACCOUNTING

Troubled Debt Restructurings

FAS 15 establishes the accounting treatment for "troubled debt restructurings." The Statement defines a troubled debt restructuring as one in which the bank, for economic or legal

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reasons related to the borrower's financial difficulties, grants a concession to the borrowe, that it would not otherwise consider. It is important to note that all restructurings do not meet this definition. For example, a loan which is extended or renewed at a interest rate equal to the current rate for new loans with similar risk would not be classified as a troubled debt restructuring even if the new rate is less than the previous rate. Therefore, only troubled debt restructurings meeting this definition are accounted for in accordance with the Standard.

Modification of Terms

If the new terms of the troubled debt restructuring provide for a reduction of either interest or principal (referred to as a modification of terms), FAS 15 requires that the recorded amount of the loan on the bank's books (principal plus accrued interest) be compared to the total future contractual cash payments (including both principal and interest) expected to be collected. A loss is recognized only if the total of such future combined payments is less than the recorded amount of the loan. Otherwise, no loss is recognized and the only additional accounting requirement is to determine the new effective interest rate for income recognition purposes.
See Examples 1 and 2.

New Effective Interest Rate

Often, the new effective interest rate is equal to the stated loan rate included in the restructured loan document. However, adjustments may be required if (1) the loan principal is reduced, (2) the new contractual rates are on a graduated basis (e.g. 8% first year, 10% second year, etc.), (3) due and unpaid interest is not added to principal or otherwise included in the contractual interest rate amount, or (4) the repayment terms have other unusual provisions. If an effective interest rate computation is required, it should be based upon future contractual payment terms excluding all payments which are contingently payable. This rate is calculated so as to yield a constant rate of interest over the remaining life of the loan. It is expected the rate will generally be less than the original loan rate and may be as low as zero without any requirement to recognize a loss. See Example 3.

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Acceptance of Property

If the bank accepts property (i.e. farm land) in full satisfaction of the loan, the property should be written down and recorded at its fair (appraised) value. The difference between the recorded amount of the loan, including recorded accrued interest, and the fair value of the property received should be charged to the allowance for loan losses. Any future writedowns of the property should be charged against operations.

Restructuring with Acceptance of Property

A restructuring may include both a modification of terms and the acceptance of property in partial satisfaction of the loan. The accounting for such a restructuring involves a two step process. First, the recorded loan balance is reduced by the fair market value of the property received. Second, the modified payment amount is compared to the remaining recorded loan amount as explained under "modification of terms" above. See Example 4.

New Loan

The bank may extend additional credit to a borrower at interest rates below the current market rate. An example would be a new crop loan extended to give a borrower an opportunity to return to profitable operations. Since this is a new loan to the same borrower, no special accounting rules apply. Accordingly, discounting or loss recognition is not necessary. However, if the new loan is granted in connection with the restructuring of an existing loan, it will be considered part of the restructuring and accounted for as previously described.

Credit Analysis

In all troubled debt restructurings the collectibility of future payments may be questionable. Therefore, a credit analysis should be performed to determine if any additional amounts should be charged to the allowance for loan losses. The analysis should include the borrower's ability to meet the new terms of the loan based upon projected cash flows, profitability and other credit factors.

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Subject Accounting for Restructured Loans and Sales of Foreclosed Property

Sale of Foreclosed Property

The sale of foreclosed property (i.e. farm land, etc.) will often be financed by a loan made at less than current market interest rates. In this situation, APB 21 requires that the loan be discounted to bring its yield to a market rate. The effect of the discount will then be to either increase the loss or reduce the gain which results from the sales transaction. Interest income is then recognized at a constant yield over the life of the loan.

Banks may also facilitate the sale of foreclosed property by requiring little or no downpayment. In these circumstances the required accounting is set forth in FAS 66 (also see Interpretative Ruling 7.3025). In general, any profit must be deferred on sales of farm land with downpayments of less than 25% of the discounted (if required) sales price. Losses, however, should be recorded immediately. See Example 5.

This Circular is only a summary of the accounting principles which apply to troubled debt restructurings and the sales of foreclosed property. In determining the appropriate accounting for a complex transaction, reference should be made to FAS 15, FAS 66 and APB 21.

ORIGINATING OFFICE:

Questions regarding this Banking Circular may be directed to the Chief National Bank Examiner's Office, Bank Accounting Division (202) 447-0471.

H. Joe Selby
Senior Deputy Comptroller
for Bank Supervision

Date May 1, 1985

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BANKING ISSUANCE

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Type Banking Circular Subject Accounting for Restructured Loans and Sales of Foreclosed Property

Example Assumptions:

The following examples assume that the loan or a portion thereof was not charged off prior to the restructuring. If a charge-off was required, it should be recognized before the restructuring computation set forth in these examples.

Example 1 - Interest Rate Reduced

A borrower who owes the bank $125,000 is experiencing financial difficulty. The bank agrees to reduce the interest rate from 15% to 4%. Principal and interest payments are due in one year.

Contractual principal payment	$125,000
Plus: Contractual interest payment	5,000
Total cash payments expected	130,000
Less: Loan amount	125,000
Difference	$ 5,000

No loss is recognized since total contractual payments ($130,000) exceed recorded loan amount ($125,000). Interest income of $5,000 will be recognized at the stated 4% rate.

Example 2 - Principal Reduced With Loss Recognition

A borrower who owes the bank $125,000 is experiencing financial difficulty. The bank agrees to reduce the loan to $100,000. The interest rate will be 12.5%, with principal and interest due in one year. In this situation the bank will record a $12,500 loss, computed as follows:

Original recorded amount of loan	$ 125,000
Less: Contractual principal payment	(100,000)
Less: Contractual interest payment ($100,000 at 12.5%)	(12,500)
Loss (cash deficiency)	$ 12,500

The loan will be recorded on the bank's books at $112,500 rather than the contractual amount of $100,000. This is the original

recorded amount of the loan reduced by the loss. No interest income is recognized since all payments will be applied against the recorded amount of the loan.

Example 3 - Principal Reduced With No Loss Recognition

A borrower who owes the bank $125,000 is experiencing financial difficulty. The bank agrees to reduce the loan to $100,000. The interest rate will be 12.5%. Interest will be paid annually and the principal will be due in three years.

In this situation there will be no loss (assuming the loan or portion thereof was not charged off prior to the restructuring) since the total future principal and interest payments will exceed the original book value of $125,000. In addition, the bank will recognize $12,500 (at a 3.57% rate) of interest income over three years, computed as follows:

Contractual principal payment	$100,000
Plus: Contractual interest payments ($100,000 at 12.5% for 3 years)	37,500
Less: Original recorded amount of loan	(125,000)
Interest income	$ 12,500

Since no loss is recorded on this transaction, the loan remains on the bank's books at its original balance of $125,000, rather than the contractual amount. The new effective interest rate is based on the recorded amount of the loan. An interest rate of 3.57% will yield a constant rate of return over the life of the loan in relation to the outstanding book balance. Accordingly, approximately $4,500 of interest income will be recognized in the first year.

Example 4 - Principal Reduced and Property Accepted

A borrower who owes the bank $125,000 is experiencing financial difficulty. The bank agrees to accept land with a fair market value of $15,000 in partial satisfaction of the loan. In addition, the loan is modified. Under the modified agreement the customer will repay $100,000 of principal in one year and $10,000

will be forgiven. Interest, at the reduced rate of 5%, will also be paid at that time. In this situation the bank should record a $5,000 loss, computed as follows:

Original recorded value of loan	$125,000
Less: Fair market value of property accepted in partial satisfaction	(15,000)
Adjusted loan amount	110,000
Less: Future principal	(100,000)
Less: Future interest ($100,000 x 5%)	(5,000)
Loss	$ 5,000

If the interest rate was 10%, the bank would recover its entire investment and no loss would be recorded (assuming the loan or a portion thereof was not charged off prior to the restructuring). No interest income would be recognized since all payments would be used to satisfy the recorded amount of the loan. If the interest rate was 15%, the bank would recover $5,000 more than the recorded value of the loan. This amount would be recognized as interest income over the life of the loan. The computation would be as follows:

Future principal payment	$100,000
Plus: Future interest payment ($100,000 at 15%)	15,000
Less: Adjusted loan amount	(110,000)
Interest income to be recorded over the life of the loan	$ 5,000

Example 5 - OREO Sale Financed

The bank owns a tract of foreclosed farm land which is recorded on its books as Other Real Estate Owned in the amount of $85,000. The land is sold for $110,000 with the bank financing $100,000 of the purchase price. A $10,000 downpayment is received. The contractual interest rate on the loan is 6%. Principal is due in five years, and interest is paid annually. The market interest rate for similar debt is 14%.

APB 21 requires that the loan be discounted to its present or fair market value. The present value of this loan, discounted to yield a market rate of 14%, is $72,535. Therefore, the adjusted

sales price of the property is $82,535 ($10,000 + $72,535). The loss on the sale of the property is computed as follows:

Recorded amount of land	$ 85,000
Less: Downpayment	(10,000)
Less: Discounted value of loan	(72,535)
Loss on sale of land	$ 2,456

The loan discount is recognized as income over the life of the loan. It is computed as follows:

Face value of loan	$100,000
Less: Discounted value of loan	72,535
Loan discount	$ 27,465

Since the land was sold at a loss, the entire amount of that loss is booked. Note, however, that had the sale resulted in a gain, FAS 66 would have required that it be deferred because the downpayment was less than 25%.

Additional Example Factors

The above examples illustrate the proper application of generally accepted accounting principles. These illustrations should not be interpreted as preventing additional loan charge-offs or provisions to the allowance for loan and lease losses based upon credit analyses performed by the bank's management or regulatory agencies.

Mr. BARNARD. Thank you, Mr. Downey and Mr. Meadows.

Mr. Meadows, when did the FDIC implement their forbearance policy?

Mr. MEADOWS. As I recall, Mr. Chairman, I think the bank letter was mailed on March 27.

Mr. BARNARD. Of this year?

Mr. MEADOWS. This year, yes.

Mr. BARNARD. Mr. Downey, is that about the same time as the OCC?

Mr. DOWNEY. Yes, sir.

Mr. BARNARD. Mr. Meadows, you have 37 applications before you.

Mr. MEADOWS. That's correct.

Mr. BARNARD. Mr. Downey, you have 14 before you?

Mr. DOWNEY. Fourteen.

Mr. BARNARD. I consider that very, very small in number, if you consider the fact is that you have got 2,700 farm banks, I think, that you have identified. Isn't that the number?

Mr. MEADOWS. 2,700 is the number.

Mr. BARNARD. And you had 800 and——

Mr. DOWNEY. Seventy.

Mr. BARNARD. So 14 and 37 seem to be very small numbers.

Do you have a policy, or is it a part of the examiner's responsibilities, to discuss with banks that they are criticizing—do they discuss with them the forbearance program?

Mr. MEADOWS. I think, Mr. Chairman, that discussion of the Capital Forbearance Program most likely will come up during the examination process.

But I think I should point out with respect to the numbers, while I don't have specific numbers, the number of FDIC-supervised State nonmember banks with capital ratios over the threshold level is very similar to what Mr. Downey says. There aren't that many banks falling between the 4- and 6-percent normal threshold levels. In fact, I think we pointed out in our statement that there were only in the neighborhood of 37 or 38 in that range at the present time. However, this changes daily.

I expect that capital forbearance applications will be examination driven, and we will get the applications as examinations take place, or get the applications as exams are concluded.

Mr. BARNARD. In other words, you are saying that you believe that in the future your examiners will encourage applications for the forbearance program?

Mr. MEADOWS. I don't know if I want to use the term encourage, because I think the examiner would point out if a bank is definitely eligible for capital forbearance, but I think an examiner has to be very careful that he does not commit that capital forbearance will be forthcoming in situations that may be questionable.

Mr. BARNARD. The reason I'm asking that question, of course, is, Dr. Seidman has said that the number of applications to date has not been significant, but of course I can't evaluate whether 37 is significant or not. Of course, the forbearance program has only been in being for—what?—3 or 4 months at this particular time. So I'm sure that 37 is significant to those 37 who have made application, and to the 14 national banks that have made application to the OCC.

The point I'm making is that if the FDIC and the OCC really genuinely feel that there are banks out there who are deserving of this special consideration, they could probably be more easily identified or, I go back to the word "encouraged," by their examiners, because they will have had the benefit of a lot more knowledge of this bank's management and their practices, and how they have responded to problem loans in the past.

Mr. MEADOWS. If I could say one thing, Mr. Chairman, we have issued instructions to examiners to comment in the report of examination. We have asked for the comment to be in the confidential portion of the report of examination under the heading of "Capital Forbearance Consideration," in which the examiner will outline his feelings as to whether or not he feels that the particular bank under examination—assuming its capital falls within the parameters—is eligible for capital forbearance and the reasons why it would or would not be.

Mr. BARNARD. Have you got any ideas as to why at this point none of the 37 applications have been approved?

Mr. MEADOWS. I think that we have got to look at the timeframes here. It's true that the bank letter did go out on March 27, which is approximately 2½ months ago. It takes time for banks to receive it. As part of the application process, they have got to evaluate their position and come up with a capital plan. Frequently, this requires either a meeting or a consultation by telephone with our regional office or perhaps one of our field offices.

I frankly think that it's just a little bit early in the game to expect too much action to be taken on these applications. We had very few of them as of the end of April. Most of them flowed into the regional offices during the month of May, and we do expect action on them soon.

Mr. BARNARD. What happens between the time that you receive an application and the next examination? In other words, have you had an experience whereby you have actually had to close a bank where its application for forbearance had been submitted?

Mr. MEADOWS. I recall that one or two banks have been closed, and they had applied for capital forbearance. However, I would note that under the guidelines they would not be eligible, and the chartering authority found them to be insolvent. So insolvent banks aren't eligible for forbearance in that respect.

Mr. BARNARD. Mr. Downey, I know in your 14 banks who applied there was one that was closed or failed soon afterwards. Is there any grace period in there between the time that you get an application and the time that you recommend that a bank be closed?

Mr. DOWNEY. In the case where the bank failed, the application was made immediately after we announced the capital forbearance program, and the bank was closed that following Friday.

The capital forbearance policy is not intended to keep an insolvent bank open. There is a perception in a lot of bankers' minds that the regulator always wants to maintain a certain level of capital in a particular bank and that any time that capital drops because of losses, et cetera, we are going to force it back up to the historical level. A lot of people are looking at the number of applications that are being received. I think the good has been done, and a lot of bankers are now willing to accept losses on some of

their loans with the understanding that we are not going to come in and ask them to go up to those historical capital levels. But capital forbearance in no way is going to keep a bank from failing, and it's not intended to do so.

Mr. BARNARD. Is there any way you can tell us this morning about how you intend to treat applications from banks without enough farm loans to make them agricultural banks but with the same heavy dependence on the agriculture economies of their communities?

In other words, right now the determination is about how many actual farm loans are in their portfolio but, as we have heard this morning from the gentleman from Idaho, there are other indications which will determine whether or not you may be a farm bank.

Mr. DOWNEY. We will consider, on a case-by-case basis, extending capital forbearance to banks that do not qualify under the guidelines we have set, 25 percent of the portfolio.

Mr. MEADOWS. We intend to be very flexible in this regard, and, frankly, I consider a loan to an implement dealer to be an agricultural loan. It may or may not fit the definition under the call report instructions, but many of those commercial-type loans are agricultural loans, as far as I'm concerned.

Mr. BARNARD. Mr. Craig.

Mr. CRAIG. I'd like to broaden this line of questioning just a little bit. Mr. Meadows, do your examiners consider those kinds of loans ag loans?

Mr. MEADOWS. Well, I think they probably do. I think in most areas they probably do, but I think the important question with respect to the forbearance, a bank has to make its case for qualifying for capital forbearance, and I think that most banks in farm communities, if there is some question as to whether or not they are an agricultural bank because they don't have enough crop production loans and so forth——

Mr. CRAIG. We're talking about your directive and the percentage of portfolio. Therefore, that clearly aligns itself with the definition of what you call an ag loan.

A case in point, with the OCC, and your definition of oil and gas loans and what would qualify. I am looking at your regulations, and in this case, down here you're talking of the type of loans, and you get to loans to manufacturers and leasers of oil field machinery and equipment. That is broadening the range out beyond what might be defined strictly as an oil loan.

I am asking, is it true in FDIC that your regulations clearly identify what is or is not an ag loan, and therefore do your examiners classify? Therefore, does a bank, looking at application for forbearance, fall under the percentage based on a narrow definition, or whatever the definition is, where we would say out in ag country that that implement dealer loan, and maybe the fertilizer dealer loan, and a variety of those other dealers are clearly ag loans, although ag related, rise and fall with the ag tide, therefore ag loans? Are you that clear and that specific?

Mr. MEADOWS. The definition for agricultural loans is contained in the instructions for completion of reports of condition. The instructions are the same for national banks, Fed member banks,

and State banks, and that is how we get the 25 percent of loan portfolio; it's based on those instructions.

I regret that I cannot recall whether those instructions say that an implement dealer loan or a loan of that type is considered an agricultural loan or not. In my own mind, I think that a very strong case can be made that it is, in fact, an agricultural loan. I'm just not prepared to answer that question.

Mr. CRAIG. I would concur with you that the case could be made. I guess I'm saying, is it? And you are saying that it is because of the instructions. Is it clear to the bank in deciding whether they do fall in or out of the necessary percentage, therefore to become an applicant, when, if that percentage, based on definition and perception or understanding of definition, might change 2 or 3 points and change significantly the number of banks who could become ultimate participants?

Mr. MEADOWS. The banks have a copy of the same instructions that the examiners have, and many bankers have said the instructions aren't that clear, but I think it's reasonably clear on what is an ag loan and what is not. But I just don't recall specifically what all is included in that definition.

Mr. CRAIG. Thank you, Mr. Chairman.

Mr. BARNARD. Let me just pursue one thing. One of the things you insist upon, or one of the things that always pops out very significantly, is the quality of management. In other words, if the bank does not have good management, then that's the ingredient by which you determine if forbearance is approved or not approved.

I guess you could spend months and months talking about what the ingredients of good management would be, but, just briefly, what in your mind determines good and bad management?

Mr. MEADOWS. I think the most important thing that an examiner does during the examination process is to evaluate management, and it's also the most difficult thing that an examiner has to do.

Certainly the results of a particular institution are crucial in determining the adequacy of a particular management. Set aside the insider abuse, I think those are obvious situations, and I think we can all deal with those and define them in the same way probably, but I think you have to look at the earnings of the institution, the asset quality, whether or not the bank is liquid, are they pursuing reckless growth policies, or something of that nature, and you come up to a management rating, hopefully not overly based upon the actual condition of the bank because often—and we've particularly seen it in the two sectors, energy and agriculture, that we are talking about today—banks' difficulties are a result of economic conditions perhaps beyond their control.

At the same time, I think Mr. Brooks was saying—I think I heard it this morning—that it's unusual sometimes to see two similar banks in the same community and both making the same type loans, and one is a problem and one is not, for some reason; maybe one is managed better than the other.

But I think in the final analysis the examiner has to answer the question, is this management doing the best it can under the circumstances? Does it recognize the problems that it is faced with, and does it have the willingness to do something about them?

Mr. BARNARD. Mr. Downey.

Mr. DOWNEY. As an examiner, I'd say that my evaluation of management followed from my evaluation of asset quality and earnings. Therefore, if a bank had a lot of problem loans, the management was bad; if it didn't have any problem loans, the management was good. That's not always true, however, particularly in today's economy.

We struggled with how we were going to communicate to our examiners what constitutes a well-managed bank because we felt that a lot of examiners might take the same approach that I had always taken. What we told them in our banking issuance was that they should make that determination based on the way in which that management team had reacted to prior criticisms, for example, if they were operating under a formal agreement, what efforts they were making to comply with it, and get away from the sole basis being how many assets were criticized and what the ROA or ROE was. We are assuming a bank is well managed unless we have strong indications that that management has not made attempts to rectify problems that were brought to their attention in the past.

Mr. BARNARD. I can see that we could go on and on and on, on this question of management. But as I listen to both of you, both of you are putting the stress on one thing, and that is operations.

There's a lot that goes into the managing of a bank other than operations. You can take a bank that is going to put 90 percent of its assets into U.S. Treasury bills. The problem is, are they serving their community? Being able to adequately serve your community and make loans in your community and, at the same time, make money and keep your losses at a low ebb—all of that.

One of the most onerous laws that is on the books today is known as the Community Reinvestment Act. I say that publicly. I say to the Banking Committee every time I get a chance to, and on the floor of the Congress, we don't need a Community Reinvestment Act.

Mr. SPRATT. But it's not onerous because it's not substantively enforced. What we are looking at today is clear evidence of that.

Have you heard anybody here today say that you get a plus if you have reinvested your assets in your own community? No, of course not. What you do is, list your officers who belong to the Rotary Club and the last time you had somebody who headed up the United Fund, and things like this. It's just a drill; it's not substantive. If it were, they would try to be saying, "Well, we've got a lot of balls to juggle in the air."

Mr. BARNARD. But you see how the problem comes about, though. You are asking the regulators to do two things.

Mr. SPRATT. I know. We ask them to do irreconcilable things. That's why it's difficult.

Mr. BARNARD. You're asking them to keep safe and sound and then the next thing is to make bad loans in order to serve your community—it's a ticklish question.

The point I'm making, though, in management—shouldn't there be some consideration of what you are supposed to be doing in your community now? Take, for example, if you are in a farm area, you ought to be making farm loans. If you are in an energy area, you ought to be making energy loans.

Mr. MEADOWS. Mr. Chairman, I would agree with that, and I would like to summarize one paragraph which went out to our field staff which perhaps will sum up our attitude toward management.

Basically, what this says is that the capital forbearance determination will be based on whether an institution has been s.gnificantly mismanaged, not simply whether it has been well-managed.

In other words, we have two extremes here. We have the well-managed banks and the significantly mismanaged banks. The significantly mismanaged banks would not qualify for the capital forbearance. I would hope we would all agree on that. In between, there is a wide group of bank managements. I have tried to give the message to our field people, and I think they have received it—at least most of them have received it—that this in between group, most of them will qualify for capital forbearance if all the other qualifications are met.

Mr. BARNARD. I can see that when you are talking about 37 cases and you already have on the books 1,080 banks that are predicted to have real problems, I guess 37 is not too significant.

Mr. Craig.

Mr. CRAIG. Thank you very much, Mr. Chairman.

Mr. Meadows, Mr. Downey, thank you for coming to our committee this morning and offering your testimony and standing for questions.

Mr. Meadows, I'd like to go back a few months preceding FDIC's issuance of the capital forbearance policy. Can you tell me what events occurred that led to FDIC's issuance of the policy in late March?

Mr. MEADOWS. Mr. Craig, a lot happened during that period. I think there was a great deal of pressure being brought to bear from various groups, banking groups, particularly in the Farm Belt, to grant some sort of assistance to farm banks, assistance in the form of net worth certificates or some other form of capital-type assistance, to enable these banks to buy time until the agricultural economy was reinvigorated.

After considering the various proposals—and I think maybe direct financial assistance was talked about also—the regulators agreed upon capital forbearance as being a viable alternative.

Mr. CRAIG. I thought it was interesting to note that on March 6 Senator Garn's Banking Committee held hearings on a number of bank relief proposals, and on March 11 FDIC/OCC revealed their capital forbearance policy. Do you think there is any direct relationship between what was going on in the Senate and what ultimately came from both the FDIC and OCC?

Mr. MEADOWS. I think probably so, yes.

Mr. CRAIG. Can you tell me what the FDIC's opinion was of Senate bill 2231?

Mr. MEADOWS. I am not sure—the number doesn't mean anything to me. Can you tell me what——

Mr. CRAIG. That would require the FDIC, the OCC, and the Fed to give farm and energy bank leeway in restructuring debt and finding other ways to help customers pay off their outstanding loans. It permits regulators to let banks reduce capital reserves and to ease the pressure on banks to dispose of land acquired through foreclosure.

Mr. MEADOWS. I think we thought that the same ends could be accomplished without legislation.

Mr. CRAIG. In other words, you are telling me that FDIC was opposed.

Mr. MEADOWS. I frankly do not recall what our position was at that point in time. I don't know that we were voicing strong opposition to it.

Mr. CRAIG. Can it be said—more importantly, would you say that the FDIC issued capital forbearance policies to keep from having major bank relief legislation passed?

Mr. MEADOWS. No, I cannot say that.

Mr. CRAIG. Let me go back to the definition of an ag loan. I have here your capital forbearance issuance statement that went to the chief executive officers of insured State nonmember banks. It says;

> The bank must meet the definition of an agriculture/oil and gas bank. An agricultural/oil and gas bank is one whose agriculture and oil and gas loans, in the aggregate, are equal to or greater than 25 percent of the bank's total loans' and leases' net or earned income. Agricultural loans are defined as loans secured by farm land and loans to finance agricultural production and other loans to farmers from schedule C on the bank's call report of condition.

That is all that is said in your whole statement as it relates to ag loans. As it relates to oil and gas loans, there is attached a rather significant list, A through K, of what is considered an oil and gas loan, what appears to me to be a much broader definition, at least at first glance.

So I guess I would ask, in the case of the OCC we have in the Federal Register of April 23 a listing of the definition of oil and gas loans. Did FDIC follow suit in the same manner in issuing forth a clear definition as to what an ag loan is?

Mr. MEADOWS. I don't recall that we did, but I don't know with any certainty. But let me say just one thing. I did not expect there to be that great a debate as to whether banks would have difficulty meeting the qualification of agricultural banks.

I think, in looking at agricultural banks, most of them had loans far in excess of the 25 percent anyway, and if there were banks which felt like they qualified for capital forbearance, they had a lower ratio, then they could make their case, and I'm not aware that anyone has come forward to make their case yet, but I think it's clear in the bank letter that went out that other banks falling below the 25 percent may qualify.

Mr. CRAIG. Could you, for the record and for the committee, find for us, or provide to us, the definition and the clarity of the definition, or the broadness of the definition, as it relates to what is or is not an ag loan?

Mr. MEADOWS. Yes.

Mr. CRAIG. I would appreciate that. I think the committee would.

[The information follows:]

Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency

FFIEC 034
Page 1

Consolidated Report of Condition for All Insured Commercial Banks

All schedules are to be reported in thousands of dollars. Unless otherwise indicated, report the amount outstanding as of the last business day of the quarter.

Schedule RC—Balance Sheet

Dollar Amounts in Thousands	Bil	Mil	Thou	
ASSETS				
1. Cash and balances due from depository institutions				
a. Noninterest-bearing balances and currency and coin				1.a
b. Interest-bearing balances				1.b
2. Securities (from Schedule RC-B)				2
3. Federal funds sold and securities purchased under agreements to resell				3
4. Loans and lease financing receivables				
a. Loans and leases, net of unearned income (from Schedule RC-C)				4.a
b. LESS: Allowance for loan and lease losses				4.b
c. Loans and leases, net of unearned income and allowance for losses				4.c
5. Assets held in trading accounts				5
6. Premises and fixed assets (including capitalized leases)				6
7. Other real estate owned				7
8. Investments in unconsolidated subsidiaries and associated companies				8
9. Customers' liability to this bank on acceptances outstanding				9
10. Intangible assets				10
11. Other assets (from Schedule RC-F)				11
12. Total assets (sum of items 1 through 11)				12
LIABILITIES				
13. Deposits				
a. In domestic offices (sum of totals of columns A and C from Schedule RC-E)				13.a
(1) Noninterest-bearing				13.a.(1)
(2) Interest-bearing				13.a.(2)
b. In foreign offices, Edge and Agreement subsidiaries, and IBFs				
(1) Noninterest-bearing				
(2) Interest-bearing				
14. Federal funds purchased and securities sold under agreements to repurchase				14
15. Demand notes issued to the U.S. Treasury				15
16. Other borrowed money				16
17. Mortgage indebtedness and obligations under capitalized leases				17
18. Bank's liability on acceptances executed and outstanding				18
19. Notes and debentures subordinated to deposits				19
20. Other liabilities (from Schedule RC-G)				20
21. Total liabilities (sum of items 13 through 20)				21
22. Limited-life preferred stock				22
EQUITY CAPITAL				
23. Perpetual preferred stock				23
24. Common stock				24
25. Surplus				25
26. Undivided profits and capital reserves				26
27. Cumulative foreign currency translation adjustments				
28. Total equity capital (sum of items 23 through 27)				28
29. Total liabilities, limited-life preferred stock, and equity capital (sum of items 21, 22, and 28)				29

Schedule RC-B—Securities

Exclude assets held in trading accounts.

Dollar Amounts in Thousands	(Column A) Book Value — Bil Mil Thou	(Column B) Market Value* — Bil Mil Thou	
1. U.S. Treasury securities and U.S. Government agency and corporation obligations			
a. All holdings of U.S. Government-issued or -guaranteed certificates of participation in pools of residential mortgages	RCON	RCON	1.a
b. Other U.S. Government securities	RCON	RCON	1.b
2. Securities issued by states and political subdivisions in the U.S.	RCON	RCON	2
3. Other securities (debt and equity)			
a. All holdings of private (i.e., nongovernment-issued or -guaranteed) certificates of participation in pools of residential mortgages	RCON	RCON	3.a
b. All other securities (debt and equity)	RCON	RCON	3.b
4. Total (sum of items 1 through 3) (Total of column A must equal Schedule RC, item 2)	RCON	RCON	4
Memorandum			
1. Pledged securities	RCON	RCON	M.1

*See instructions for this schedule.

Schedule RC-C—Loans and Lease Financing Receivables

Net of unearned income and before adjustment for allowance for loan and lease losses. Exclude assets held in trading accounts.

Dollar Amounts in Thousands	Bil Mil Thou	
1. Loans secured by real estate		
a. Construction and land development	RCON	1.a
b. Secured by farmland (including farm residential and other improvements)	RCON	1.b
c. Secured by 1-4 family residential properties	RCON	1.c
d. Secured by multifamily (5 or more) residential properties	RCON	1.d
e. Secured by nonfarm nonresidential properties	RCON	1.e
2. Loans to depository institutions	RCON	2
3. Loans to finance agricultural production and other loans to farmers	RCON	3
4. Commercial and industrial loans	RCON	4
5. Acceptances of other banks	RCON	5
6. Loans to individuals for household, family, and other personal expenditures (includes purchased paper)		
a. Credit cards and related plans	RCON	6.a
b. Other	RCON	6.b
7. Obligations (other than securities) of states and political subdivisions in the U.S.	RCON	
a. Nonrated industrial development obligations	RCON	7.a
b. Other obligations (excluding securities)	RCON	7.b
8. All other loans	RCON	8
9. Lease financing receivables (net of unearned income)	RCON	9
10. LESS: Any unearned income on loans reflected in items 1-8 above	RCON	10
11. Total loans and leases, net of unearned income (sum of items 1 through 9 minus item 10) (must equal Schedule RC, item 4a)	RCON	11

LINE 1b + LINE 3 / LINE 11 = % AG LOANS

Definition Line 3 Schedule RC-C

Item No	Caption and Instructions
2(cont.)	item. (See the Glossary entry for "foreign governments and official institutions" for the definition of this term.)
	(11) Dollar exchange acceptances created by other banks or by foreign governments and official institutions (report in item 5 or 8, as appropriate)
3	***Loans to finance agricultural production and other loans to farmers.*** Report loans for the purpose of financing agricultural production. Include such loans whether secured (other than by real estate) or unsecured and whether made to farm and ranch owners and operators (including tenants) or to nonfarmers. All other loans to farmers, other than those excluded below, should also be reported in this item.
	Include as loans to finance agricultural production and other loans to farmers:
	(1) Loans and advances made for the purpose of financing agricultural production, including the growing and storing of crops, the marketing or carrying of agricultural products by the growers thereof, and the breeding, raising, fattening, or marketing of livestock.
	(2) Loans and advances made for the purpose of financing fisheries and forestries, including loans to commercial fishermen.
	(3) Agricultural notes and other notes of farmers that the bank has discounted for or purchased from merchants and dealers, either with or without recourse to the seller.
	(4) Loans to farmers that are guaranteed by the Farmers Home Administration (FmHA) or by the Small Business Administration (SBA) and that are extended, serviced, and collected by a party other than the FmHA or SBA.
	(5) Loans and advances to farmers for purchases of farm machinery, equipment, and implements.
	(6) Loans and advances to farmers for all other purposes associated with the maintenance or operations of the farm, including:
	(a) purchases of private passenger automobiles and other retail consumer goods, and
	(b) provisions for the living expenses of farmers or ranchers and their families.
	Loans to farmers for household, family, and other personal expenditures (including credit cards and related plans) that are not readily identifiable as being made to farmers need not be broken out of item 6 for inclusion in this item.
	Exclude from loans to finance agricultural production and other loans to farmers:
	(1) Loans secured by real estate (report in item 1).
	(2) Loans to farmers for commercial and industrial purposes (e.g., when a farmer is operating a business enterprise as well as a farm) (report in item 4).
	(3) Loans to farmers for the purpose of purchasing or carrying stocks, bonds, and other securities (report in item 8).
	(4) Loans to farmers secured by oil or mining production payments (report in item 4).
	(5) Notes insured by the Farmers Home Administration (FmHA) and instruments (certificates of beneficial ownership, insured note insurance contracts) representing an interest in FmHA-insured notes (report in Schedule RC-B, item 1(b)). All other U.S. Government securities. Such notes and instruments are backed by loans made, serviced, and collected by the Farmers Home Administration and were issued prior to January 1, 1975.
4	*Commercial and industrial loans.* Report loans for commercial and industrial purposes to sole proprietorships, partnerships, corporations, and other business enterprises, whether secured (other than by real estate) or unsecured, single-payment or installment. These loans may take the form of direct or purchased loans. Include the reporting bank's own acceptances that it holds in its portfolio when the account party is a commercial or industrial enterprise. Also include loans to individuals for commercial, industrial, and professional purposes but not for investment or personal expenditure purposes. *Exclude* all commercial and industrial loans held in trading accounts.

Picked up under Line 1b. Schedule RC-C

Item No.	Caption and Instructions
1(cont.)	(2) If the reporting bank has issued certificates of participation in a pool of residential mortgages it holds and does not retain significant risk of ownership, such transactions are to be reported as a sale of the underlying mortgages. Holdings of such certificates of participation are to be reported in Schedule RC-B, item 3(a).
	Include as loans secured by real estate:
	(1) Loans secured by residential properties that are guaranteed by the Farmers Home Administration (FmHA) and extended, collected, and serviced by a party other than the FmHA.
	(2) Loans secured by properties and guaranteed by governmental entities in foreign countries.
	Exclude from loans secured by real estate:
	(1) Obligations (other than securities) of states and political subdivisions in the U.S. secured by real estate (report in item 7 below).
	(2) All loans and sales contracts indirectly representing other real estate (report in Schedule RC, item 7, "Other real estate owned").
	(3) Loans to real estate companies, real estate investment trusts, mortgage lenders, and foreign non-governmental entities that specialize in mortgage loan originations and that service mortgages for other lending institutions when the real estate mortgages or similar liens on real estate are *not* sold to the bank but are merely pledged as collateral (report in item 2, "Loans to depository institutions," or item 8, "All other loans," as appropriate).
	(4) Notes issued and insured by the Farmers Home Administration and instruments (certificates of beneficial ownership and insured note insurance contracts) representing an interest in Farmers Home Administration-insured notes (report in Schedule RC-B, item 1(b), "All other U.S. Government securities").
	(5) Bonds issued by the Federal National Mortgage Association or by the Federal Home Loan Mortgage Corporation that are collateralized by residential mortgages (report in Schedule RC-B, item 1(b)).
	(6) Pooled residential mortgages against which certificates guaranteed by the U.S. Government have been issued. Treat such pooled mortgages as having been sold outright and report such certificates purchased or held as obligations of U.S. Government agencies and corporations (report in Schedule RC-B, item 1(a), "All holdings of U.S. Government-issued or -guaranteed certificates of participation in pools of residential mortgages").
1(a)	*Construction and land development.* Report loans secured by real estate with maturities of 60 months or less made to finance land development (i.e., the process of improving land—laying sewers, water pipes, etc.) preparatory to erecting new structures or the on-site construction of industrial, commercial, residential, or farm buildings. For this item, "construction" includes not only construction of new structures, but also additions or alterations to existing structures and the demolition of existing structures to make way for new structures.
	Include loans secured by real estate the proceeds of which are to be used to acquire and improve developed and undeveloped property.
	Also include loans made under Title I or Title X of the National Housing Act that conform to the definition of construction stated above and that are secured by real estate.
	Exclude from construction and land development loans:
	(1) Loans to acquire and hold vacant land (report in item 1(b), 1(c), 1(d), or 1(e), depending upon the type of structure eventually to be constructed on the property or, if unknown, according to the type of structure for which the area is primarily zoned).
	(2) Loans secured by real estate that have maturities greater than 60 months (report in item 1(b), 1(c), 1(d), or 1(e), as appropriate).
	(3) Loans to finance construction and land development that are *not* secured by real estate (report in other items, as appropriate).
1(b)	***Secured by farmland.*** Report loans secured by farmland and improvements thereon, as evidenced by mortgages or other liens. Farmland includes all land known to be used or usable for agricultural purposes, such as crop and livestock production. Farmland includes grazing or pasture land, whether tillable or not and whether wooded or not.

Item No.	Caption and Instructions
1(b)(cont.)	*Include* loans secured by farmland that are guaranteed by the Farmers Home Administration (FmHA) or by the Small Business Administration (SBA) and that are extended, serviced, and collected by any party other than FmHA or SBA. *Exclude*, however, loans extended, serviced, collected, and insured by FmHA (report in Schedule RC-B, item 1(b), All other U.S. Government securities.). Also exclude loans for farm property construction and land development purposes that mature in 60 months or less (report in item 1(a)).
1(c)	*Secured by 1-4 family residential properties.* Report permanent loans secured by real estate as evidenced by mortgages (FHA, VA, or conventional) or other liens on: (1) Nonfarm property containing 1 to 4 dwelling units (including vacation homes) or more than four dwelling units if each is separated from other units by dividing walls that extend from ground to roof (e.g., row houses, townhouses, or the like). (2) Mobile homes where (a) state laws define the purchase or holding of a mobile home as the purchase or holding of real property *and* where (b) the loan to purchase the mobile home is secured by that mobile home as evidenced by a mortgage or other instrument on real property. (3) Individual condominium dwelling units, even if in a building with five or more dwelling units. (4) Vacant lots in established single-family residential sections or in areas set aside primarily for 1 to 4 family homes. (5) Housekeeping dwellings with commercial units combined where use is primarily residential and where only 1 to 4 family dwelling units are involved. *Exclude* loans for 1 to 4 family residential property construction and land development purposes that mature in 60 months or less (report in item 1(a)).
1(d)	*Secured by multifamily (5 or more) residential properties.* Report all other permanent nonfarm residential loans secured by real estate as evidenced by mortgages (FHA and conventional) or other liens. Specifically include loans on: (1) Nonfarm properties with 5 or more dwelling units in structures (including apartment buildings and apartment hotels) used primarily to accommodate households on a more or less permanent basis. (2) 5 or more unit housekeeping dwellings with commercial units combined where use is primarily residential. (3) Cooperative-type apartment buildings containing 5 or more dwelling units. (4) Vacant lots in established multifamily residential sections or in areas set aside primarily for multifamily residential properties. *Exclude* loans for multifamily residential property construction and land development purposes that mature in 60 months or less (report in item 1(a)). Also exclude loans secured by nonfarm nonresidential properties (report in item 1(e)).
1(e)	*Secured by nonfarm nonresidential properties.* Report loans secured by real estate as evidenced by mortgages or other liens on business and industrial properties, hotels, motels, churches, hospitals, educational and charitable institutions, dormitories, clubs, lodges, association buildings, homes for aged persons and orphans, golf courses, recreational facilities, and similar properties. *Exclude* loans for nonfarm nonresidential property construction and land development purposes maturing in 60 months or less (report in item 1(a)).
2	*Loans to depository institutions.* Report all loans (other than those secured by real estate) including overdrafts, to banks, other depository institutions, and other associations, companies, and financial intermediaries whose primary business is to accept deposits and to extend credit for business or for personal expenditure purposes. Depository institutions cover: (1) commercial banks in the U.S., including: (a) U.S. branches and agencies of foreign banks, U.S. branches and agencies of foreign official banking institutions, and investment companies that are chartered under Article

FDIC
OFFICE OF THE CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION, Washington DC 20429

CAPITAL FORBEARANCE

BL-12-86
March 27, 1986

TO: CHIEF EXECUTIVE OFFICERS OF
INSURED STATE NONMEMBER BANKS

SUBJECT: Statement of Policy on Principles
of Capital Forbearance for Banks with
Concentrations in Agriculture and Oil and Gas

The FDIC recognizes the severe economic problems currently being experienced by the agricultural and oil and gas sectors of the economy. It is further recognized that these problems have resulted in severe financial stress on a number of financial institutions principally engaged in serving these sectors. In light of these circumstances, the FDIC, in cooperation with the other federal bank regulatory agencies, has developed and endorsed a policy of capital forbearance in order to provide greater operational flexibility to well-managed, economically sound banks with concentrations in agriculture or oil and gas. The purpose of this statement is to provide an explanation of the FDIC's program for implementing the policy of capital forbearance.

This statement is issued with the understanding that the Congress is also considering legislation on the subject. Modification of this policy may be necessary to accommodate final Congressional action.

The capital forbearance program will be effective immediately and terminate on January 1, 1993. Forbearance means the FDIC will not take administrative action to enforce normal capital standards (as established in 12 CFR Part 325) against banks whose primary capital ratio declines to no less than four percent between now and December 31, 1987, provided the participating banks meet the following qualifications and conditions.

1. The bank must meet the definition of an agricultural/oil and gas bank. An agricultural/oil and gas bank is one whose agricultural and oil and gas loans in the aggregate are equal to, or greater than, 25 percent of the bank's total loans and leases, net of unearned income. Agricultural loans are defined as loans secured by farmland and loans to finance agricultural production and other loans to farmers from Schedule C on the Bank's Call Report of Condition. A list of the kinds of loans qualifying as oil and gas loans for purposes of this statement is attached as Attachment A.

BEST COPY AVAILABLE

Mr. CRAIG. The reason I say that, FDIC stated that there were 4,000 banks which have at least 25 percent or more of their loan portfolio in farm loans. In your testimony today, you say there are about 2,700 that meet the definition of an agricultural bank. I'm quoting from this document.

Mr. MEADOWS. May I explain the difference?

Mr. CRAIG. Yes, I would like to know the difference.

Mr. MEADOWS. The committee requested only the information about State nonmember banks. The 4,000 includes national, Fed member, and State nonmember banks.

Mr. CRAIG. How many of them are FDIC insured? Only the non?

Mr. MEADOWS. All of them are insured.

Mr. CRAIG. So all of them would fall under the definition as put forth by FDIC?

Mr. MEADOWS. The 4,000.

Mr. CRAIG. Yes.

Mr. MEADOWS. Yes.

Mr. CRAIG. As to what is or is not an ag bank or an ag loan?

Mr. MEADOWS. Yes, and this is taken from information reported by the institutions themselves on their call reports.

Mr. CRAIG. Can you tell me, or tell the committee, how many troubled FDIC-insured agricultural banks you currently have on your list that meet the definition of "troubled"?

Mr. MEADOWS. There are slightly over 1,300. Are you asking for FDIC-insured banks? There are approximately 1,300 insured banks on the problem list currently. Approximately 35 percent of those are considered agricultural banks. I would have to calculate the actual number.

Mr. CRAIG. Am I under the correct assumption that the capital forbearance policy most likely will not assist these troubled banks?

Mr. MEADOWS. I think the capital forbearance policy can possibly help some of them but not all of them.

Mr. BARNARD. May I ask a question at that point?

Mr. CRAIG. Yes.

Mr. BARNARD. The reason it cannot help them is because the minimum capital requirement is going to be 5.2 percent—right?

Mr. MEADOWS. The minimum——

Mr. BARNARD. I mean, what you are doing today. Can you get into the capital forbearance program with less than 5.2 percent capital?

Mr. MEADOWS. Oh, yes; it's 4 percent, or it could go down to 3 percent.

Mr. BARNARD. All right.

Mr. CRAIG. So that broadens it considerably.

Mr. BARNARD. OK. So there's no magic in between. But under 5.2 percent, that's when you consider the application?

Mr. MEADOWS. No.

Mr. DOWNEY. They can submit an application at any point. We have, Mr. Chairman, some banks that are operating at, let's say, 6 percent, that are under an administrative action to go to 7 percent and therefore would apply to us. Those are the type of applications we are receiving right now.

Mr. BARNARD. I see. It's after you have identified those banks as problem banks. Excuse me. Thank you.

Mr. CRAIG. The reason I ask this—you know, at which level do we have a troubled bank? Are we getting to a point where capital forbearance in some instances might avert that, or are we waiting until they get to that point before we provide capital forbearance or provide them with the opportunity to make application?

Mr. MEADOWS. I think that most banks are probably not going to apply for capital forbearance until one of two events occurs. One is that, on their own, through their charge-off of losses or operating losses, their capital falls below the minimum levels. The second would be, they come under regulatory pressure to increase capital to an even higher level than, say, 6 percent, as Mr. Downey was saying. That will trigger applications, I think.

Mr. DOWNEY. I think in the past we may have had a tendency to ask, as Mr. Howard pointed out, that capital be increased in a very short period of time during a very difficult period. What capital forbearance is doing is giving a bank a little longer to increase its capital up toward those levels rather than a period of 2 or 3 months. We are saying, in this particular case, 5 years. That's a major change.

Mr. CRAIG. You are saying then, at this time, the short time-frame requirement to increase capital is not being used?

Mr. DOWNEY. It may be in some cases necessary that there be an immediate injection of capital and then a further period of time in which to build it up to a higher level, but in most cases, I would say, where we have a plan and have confidence in management to get capital back up there, the bank is being given the the additional time to do it.

Mr. CRAIG. Mr. Meadows, I would like to walk through with you now a better understanding of what causes a request or an application for forbearance and what is the response level as to whether an application is accepted for review by FDIC.

You mentioned that you think it is now your understanding that examiners have the capability of making recommendation to banks that they might qualify.

Mr. MEADOWS. Yes.

Mr. CRAIG. And if they think they might qualify, then an application is put together, and it is sent where?

Mr. MEADOWS. It would be sent to one of our regional offices.

Mr. CRAIG. Is it a policy to discourage application in some instances or to accept and then reject?

Mr. MEADOWS. I don't think it's a policy to discourage applications, although some applications or some inquiries have been from institutions which very obviously could not qualify.

Mr. CRAIG. The reason I'm reacting to that is the situation of one of our earlier panelists who spoke of numerous suggestions for rejection or at least discouragements from making application.

I'm curious as to what are the consequences for a bank who would, following an examination and the development of a course of action agreed upon by FDIC and the bank, to then go ahead and apply, as they were following this course of action and procedure necessary to increase capital and do other things to alleviate certain problems, wherein lies the problem, if that bank sees, based on the directive, an opportunity to give them somewhat greater flexi-

bility to accomplish their goal that falls within the directive of them going ahead to apply.

Mr. MEADOWS. I see no consequence of applying. I think the bank should apply.

Mr. CRAIG. In a discussion that we had last week, you and I, we discussed this concern, and you said that all capital forbearance denials would be reviewed by Washington. You're talking about after the application, I assume.

Mr. MEADOWS. That's correct. I think I went a little bit further to indicate that they would be reviewed by me personally or my assistant.

Mr. CRAIG. That's correct. And I can accept that, based on the volume of applications that you currently have, that might be a manageable task by a fairly narrow group of people.

How can you review those kinds of applications that never make it to your office, that are never allowed to be submitted, if the bank is a qualifying bank?

Mr. MEADOWS. Obviously, it would be impossible to review something that is never processed. However, I would think that the institution would insist that their application be processed if they truly think that they qualify.

Mr. CRAIG. If they believed that they qualified but the regional office has told them not to apply because they don't qualify or they would not be accepted, why would they apply? That's their closest contact to you, and we all know that their word is God, in large part, and they are being sent negative signals as to their qualification for application, and yet they have viewed it and view themselves as having qualified.

Mr. MEADOWS. Well, I do believe that our regional directors intend to be as fair as they possibly can with all institutions. But, as Mr. Howard said earlier, bankers are human, and examiners are human, and we sometimes have disagreements, and we sometimes make mistakes.

Hopefully, there will not be very many mistakes and, if mistakes are made, that somehow those mistakes will come to the attention of either the regional director or appropriate people in Washington who can look at the situation and decide whether or not the proper decision was made.

I think I heard of a case today that I want to look at this afternoon.

Mr. CRAIG. I guess the thing that concerns me most—and it was one of the reasons I began to question the intent of, and the sincerity of the intent of, the forbearance directive, and whether they were in fact to stave off congressional action or whether they were really meant to hit the ground running and to serve a need within those parameters, as we discussed some time ago and as have been mentioned today, of prudent banking practices.

It is interesting to me that in most areas where we have an application process, whether it be in the private sector or whether it is a private, public-related sector, whether it's Farm Home, usually the individual or the collective group, if they view that they are qualified, are allowed to make application, and it is then the judgment of the examination board, or whatever group that is charged with the responsibility of examining the value of the application,

and to see whether it falls into the guidelines specified in the application, as to whether it was just or inadequate and therefore refused.

I seem to be hearing that somehow, prior to that process, there is a judgment call being made that renders a bank or, in this case, a bank—certainly blights their willingness from making application. I'm wondering if that's just.

I guess what I'm really wondering is, what are the consequences if a bank ignores a regional person and says, "You're wrong; we're right; we're going to go ahead and apply anyway."

Mr. MEADOWS. As I said earlier, I don't see that there would be any adverse consequences. An applicant has the right to apply. At the same time, I think there are some applicants that, obviously, to any reasonable person, would not qualify—for example, an insolvent bank.

Mr. CRAIG. Surely.

Mr. MEADOWS. Or a bank that is fraught with insider abuse and no corrections have been made. I find no fault with a regional director or other regional staff in telling that bank, up front, "I think it would be a waste of your time to file an application for capital forbearance. But, if you want to do it anyway, we'll have to process it."

Mr. CRAIG. I accept that. I have no difficulty with that, and I think Mr. Downey has said they received an application one day and a couple of days later the bank was down. There was no way they could have helped them in the beginning. But I did not hear that there was a resistance to allow them to make application in the first instance, and I guess that's what I'm concerned about.

I'm not going to go into the discussion of management. I think we've probably handled that well enough this morning, Mr. Chairman.

Mr. Downey, last January Mr. Clark spoke about a need to find a way to permit farm banks to diversify by purchasing portions of loans originally made by money center banks. What has become of that idea?

Mr. DOWNEY. We are still diligently working on solutions to achieve diversification in banks where diversification is determined to be in the best interests of those banks. We are dealing with issues like Glass-Steagall and a few others.

Mr. BARNARD. You didn't get that idea from Continental, did you?

Mr. DOWNEY. A couple of years ago, we put out a banking circular which makes it onerous to sell participations in loans. For example, a small correspondent bank would have to have the same information that the larger bank would have on that loan, and, therefore, the documentation that would have to accompany participation would be great. We still believe there is a need for that information because banks should make sure of their assets. We are, however, looking for ways in which to facilitate the purchase and sale of loans between banks when such is desired by both parties. There are some obstacles to that right now which we are trying to work on.

Mr. CRAIG. You have not been able to put together the necessary policy or regulations that would allow that kind of participation?

Mr. DOWNEY. Not at this point in time.

Mr. BARNARD. On participation loans?

Mr. DOWNEY. Not on participation loans. We're talking about the pooling of loans and selling pieces, which run into Glass-Steagall problems.

A lot of people in the private sector, as a result of Mr. Clarke's remarks, have suggested ways to do this. So we have gotten a lot of interest in that area, and we hope to arrive at something that will benefit the banks. I think diversification is the key, as we have learned from some of the problems in the past.

Mr. CRAIG. One last question, Mr. Chairman, of Mr. Meadows.

The current forbearance policy that you folks are working through at this time, who does it really benefit? I say that in relation to FASB 15. Comparing the two, how do you come down in evaluating who gains the benefit?

Mr. MEADOWS. I think the Capital Forbearance Program and FASB 15 are designed to help both the bank and the borrowers. The bank would be able to buy time to restore their bank to an adequately capitalized bank over a period of time. The borrowers, through restructuring, or perhaps the exercise of forbearance on the part of the bank—if the bank is getting forbearance, then perhaps some borrowers should get forbearance also.

So we think banks should work with the borrowers to achieve what is best for the bank and the borrower. Now forbearance obviously won't work for all borrowers, but it should work for some of them, I would hope. But I would certainly hope that both the bank and the borrowers would be helped.

Mr. CRAIG. I asked both of you this question the other day. I would like to now ask it to you for the record. It will only be one, Mr. Chairman. It's a question on management.

Mr. BARNARD. That's OK.

Mr. CRAIG. Do you believe the decision made by OCC and FDIC as it relates to management is arbitrary?

Mr. MEADOWS. I do not think it is arbitrary in a vast majority of the cases, but, as I said earlier, examiners are human, and it's possible that some arbitrary decisions have been made. But that's why we have a review process in the regional office and also in the Washington office, to try to detect any arbitrariness on the part of anything that is in the report. We expect the examiner to be able to support whatever management rating he assigns to any particular management.

Mr. CRAIG. Mr. Downey?

Mr. DOWNEY. I don't believe it's arbitrary. I think it's a judgment. It's probably the most difficult job an examiner has to do, because I think when we turn the lights out on the system each evening, it all boils down to how good the management was, and we have spent a lot of time trying to evaluate it. But it's not arbitrary. It takes a lot of good judgment, and seasoned people can do a good job at it.

Mr. CRAIG. Thank you both very much for coming this morning and being so willing to respond to questions.

Thank you, Mr. Chairman.

Mr. BARNARD. Mr. Meadows, before closing, I'm trying to relate a piece of legislation, H.R. 4701, which we are considering in the

Banking Committee at this particular time, which, as you know, is the regulators emergency bank bill. Is there any way to relate that piece of legislation to farm loans such as we have been talking about today?

In other words, is there any relationship between what we were talking about today, forbearance and maintaining a bank's existence in a community, and this emergency banking bill And, if so, why wasn't the threshold dropped?

I see, first of all, that the threshold was dropped only to $250 million as applied to banks, and I understand that, and there is going to be a move to put it back to $500 million, and I'm very understanding about that. But there has been nothing done to permit the extension of these emergency powers to smaller banks, which are primarily agricultural and energy banks.

Is the forbearance program—is it such a program that can take the place of that?

Mr. MEADOWS. No, Mr. Chairman, I don't think the forbearance program could take the place of some sort of emergency legislation. Personally, and I don't think I'm necessarily speaking for the FDIC, I would like to see the threshold lower because I'm responsible for handling the five or six bank failures we have every week. We had a pretty long weekend this past weekend trying to handle a couple of fairly sizable institutions, one around $100 million and one around $200 million, and there was not a great deal of bidder interest in them. I would have liked to have expanded the field of bidders for those institutions, and I think we would have maybe finished up on Friday instead of Sunday evening.

But, no, I don't think capital forbearance will necessarily replace the need for emergency legislation. I don't think it will prevent bank failures. It will buy some time for some institutions to restore themselves through the normal course through earnings, provided the farm economy turns around. If the economy doesn't turn around, we're in for a very long and difficult period.

Mr. BARNARD. The 35 percent of the 1,300 banks that are on the troubled list, 35 percent of them are farm banks, and let's say of that 35 percent, what are we talking about in terms of——

Mr. MEADOWS. 455.

Mr. BARNARD. 455 banks. I would say that of that 455 the real serious ones would be no more than—what?—200, maybe 250.

Mr. MEADOWS. Probably. By saying "real serious," that doesn't mean that that number is going to fail. Probably a much smaller percentage.

Mr. BARNARD. So we'll say about 20 percent of them would fail then.

Mr. MEADOWS. Ten to twenty—closer to ten.

Mr. BARNARD. That's not going to tremendously impact the corpus of the FDIC, is it?

Mr. MEADOWS. We do not think so.

Mr. BARNARD. Well, gentlemen, I appreciate your bringing this report. I think that the forbearance program is a good program. I think that it is certainly going to continue its energetic support on the part of both of your agencies.

The Federal Reserve doesn't have a forbearance program—or do you know if it does? It does?

Mr. MEADOWS. Yes, they do.

Mr. BARNARD. I think it's a program that we certainly need to maintain some real support for. It will be interesting for us, say, maybe this time next year, to come back and review what has been done and whether or not it has been successful and we have been able to maintain the survival of some banks and some communities that we would have otherwise lost. I think that's the main purpose of it, to serve the community.

Thank you very much for being with us this morning. With that, the subcommittee is adjourned.

[Whereupon, at 12:55 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

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